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TECHNIQUES OF INVESTIGATION FOR ASSESSMENT

Vol 6

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First Impression: June 2020

Techniques of Investigation for Assessment

Vol. 6

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Designed, Typeset and Printed by
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Foreword

As the financial ecosystem is evolving and changing rapidly, the tax authorities are required to keep themselves abreast with the latest developments in the field of tax investigation. There has been a seminal change in the way in which financial transactions are carried out. Owing to that, the methodology to track and analyze such transactions from the perspective of a tax investigator has also undergone a drastic change. In this backdrop, a need was felt to revise the existing '***Manual on Techniques of Investigation***', which was last released in the year 2002.

The scope of the updated and revised Manual is to give the officers of the Income–tax Department an overview of the modern techniques of investigations. The Volume 6 of the Manual contains useful information on various industries like Marble, Mineral, Granite, Cement, Petrochemical Industries etc. This volume provides thorough insight on the varied aspects of the industries covered, which will immensely help the officers in understanding the trade and assessing it judiciously.

I would like to place on record my special appreciation for the efforts of all the members of the Committee and other officers associated with the mammoth task of rewriting this Manual. I hope, this Manual will act as a useful reference point for the officers of the department, while conducting inquiries and investigation.

P.C. Mody
Chairman and Member (Investigation)(A/C)
Central Board of Direct Taxes

New Delhi
Date: 26/06/2020

Preface

This is Volume–6 of "Techniques of Investigation Manual". It is an effort to sensitize and educate the officers to effectively equip themselves with the requisite skill set. The Board had constituted a Committee on 27/11/2017 for review and update the departmental publication of "Techniques of Investigation Manual" (Vol. I to Vol. V) 2002. The need for the same had arisen from the fact that the earlier publication was more than 16 years old. The Committee decided to bring the manual in seven volumes. The Committee has great pleasure in bringing out the present Volume-6 of the Manual which contains chapters on specific sectors like Cement and Cement Products, Drugs and Pharmaceuticals, Petrochemicals and Chemical Industry and Jewellery, Bullion and Precious Stones, etc. The work involved re-writing the existing chapters incorporating the refinements undergone in old methods of tax evasion and incorporating the changes in the statute and the procedures.

The basic principles of taxation are as old as organized human society. Several ancient civilizations, including the Greeks and Romans, levied taxes on their citizens to pay for military expenses and other public services. Taxation dates back in India from ancient times. The celebrated poet Kalidas in his epic poem Raghuvansa has said:

> *"It was only for the good of his subjects that he (king) collected taxes from them, just as the sun draws moisture from the Earth to give it back a thousand fold."*

However, the human tendency to avoid paying taxes was also known to exist from earlier times. People had started using certain avenues to avoid payment of taxes. Thus the role of the tax administrators became crucial in ensuring that every eligible person must pay tax correctly. So the provision of investigation in the existing income-tax law is an important aspect. These investigative powers coupled with information gathering tools form the backbone of any judicious assessment order.

Nowadays businesses have witnessed significant technological advancements. They have adopted technology, resulting in change in the methods and manner of doing business. As a result, the scope and meaning of investigation has also changed. The internet, perhaps one of the most important achievement of mankind, has made practically all information available to us in no time. Investigation today has to match with the fast pace of technological developments and the technological infrastructure of the income-tax department is playing a significant role. The Tax Authorities have to scale themselves up to meet the newer challenges posed to them in the form of digital transactions of business affairs.

The Government has recently taken various initiatives to unearth the black money *viz.* Demonetization, Revamping the Benami Transactions Act, bringing in various amendments in respect of reporting cash transaction and transactions over a particular threshold, mandatory quoting of PAN, etc. It is now the responsibility of the Tax Officers to use the information and authority under the law to enforce payment of correct taxes. The recent judicial pronouncements on the relevant topics have also been incorporated.

The chapters are not an exhaustive list of techniques of investigation as the tax avoidance and evasion practices are quite diverse and dynamic in nature. However, it intends to highlight and guide the officers to make them aware about the existing provisions of law and techniques that they can apply independently to tackle the tax evasion issue in the facts and circumstances of the particular case. We attempted to utilize the earlier and newer investigation techniques to address the issue of tax avoidance and evasion in the complex digital business space. It is hoped that officers in the field find this book useful and make best use of the intended knowledge sharing while solving cases of tax evasion effectively.

The Committee acknowledges the effort of all the officers who have contributed material and made value addition for compilation of this Volume. We are also grateful to the Editorial Board for going painstakingly through the write-ups and for their valuable inputs.

Ajai Das Mehrotra
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CHAPTER

1

Minerals and Mining

1. INTRODUCTION

India is rich in mineral wealth. The exploitation of mineral resources in the country has been from ancient times. During the early Indian civilizations we hear of the use of copper and bronze weapons, an indication that these minerals were mined in the country. Systematic exploration of our mineral resources began with the coming of the British. The Geological Survey of India, which has celebrated its 125th anniversary, was the first governmental organisation that took up the systematic mapping of the mineral resources of the country. It is understood that 98% of the country's territory has now been surveyed.

2. SOURCES OF INFORMATION

Most official information on minerals and mining can be had from the following sources:

2.1 The Geological Survey of India: This organisation has its headquarters at Kolkata. It is responsible primarily for geological mapping and geophysical survey, mineral investigation and offshore mineral exploration. The GSI has a marine wing which undertakes the mineral exploration of the oceans bed.

2.2 The Indian Bureau of Mines: The Bureau is headquartered at Nagpur. It is assigned the task of conducting extensive surveys on mining potential. It prepares detailed reports regarding the mineral potential of different areas with estimates regarding the reserves. It is concerned primarily with the mineral conservation and development rules.

2.3 The Controller of Mines and Leases: The Controller is stationed at Nagpur, and is the authority for the granting of mining leases.

3. MINERAL POLICY

In order for the Assessing Officer to be fully conversant with the profits of a particular industry dealing with minerals and mining, he should be aware of the other legislation dealing with the subject. Some of the important Acts and Rules are discussed here.

3.1 Import and Export (Control) Act 1947: This Act together with the Import Control Orders 1955, and the Export Control Orders 1977, regulates the import of minerals and their export.

Certain minerals require an export license. The export documents give the name of the party to whom the minerals are being exported, the quality and quantity of the consignment and the name of the bank in which the letter of credit has been opened. Examination of the export documents helps in identifying the sale price of the minerals being exported. Export of certain minerals is banned. Some concerns get over this ban by exporting them under a different description.

3.2 Mineral Concession Rules 1960: These Rules grant concessions to the development of mining and also provide for environmental protection. There are provisions for planting twice the number of trees destroyed by any prospecting and mining. This aspect of plantation would necessarily have to be considered from the point of view of capital or revenue expenditure. These Rules have been amended and now the provision of obtaining an Income-tax clearance certificate is no longer necessary at the time of transferring prospecting licenses or mining leases. Only an affidavit is required to be submitted stating that the returns have been filed and that tax is paid on the basis of the self-assessment as provided in the Act. While a source of information normally available by way of Income-tax clearance has been done away with, the Assessing Officer can always call for the affidavit filed.

3.3 Water (Prevention and Control of Pollution) Act 1974: All mining operations require water sources for washing and benefaction treatments. There are both central and state boards for pollution control. These boards have been empowered to stop water and electricity and also to impose fines for violations of the pollution laws. AOs may call for the reports of these authorities to determine whether any penal action has been taken against a mining concern and whether this expenditure has been debited to its profit and loss account.

3.4 Forest Conservation Act 1980 and Forest Conservation Rules 1981: Most of the prospecting for minerals are in forest tracts, which come within the purview of the Forest Conservation Act. Violation of this Act entails deterrent penalties which are often paid and hidden as revenue expenditure. This should be looked into. Further, lease of forest land can only be done with the permission of the Central Government. As part of this Act, mine owners are required to undertake certain afforestation measures. The nature of this expenditure should be verified to determine whether it is capital or revenue in content.

3.5 The Mineral Conservation and Development Rules 1988: These rules provide the basic framework within which mining in the country is carried out. The authority for control of mining is the Controller General of Mines (CGM) whose headquarters are at Nagpur. Every holder of a prospecting license is required to submit a scheme of prospecting to the CGM within a period of 60 days from the execution of the prospecting license indicating the manner in which he proposes to carry out prospecting operation in the area covered by the license.

Also, **Mines & Minerals Development Rules 2015** were also enacted for regulation of this sector. More specifically rule 8A therein came into effect since 12/01/2015 & the rules regulate lease period, leaseholders' rights, royalty/ levies & local taxes, bidding & auction process etc.

3.6 Prospecting is required to be carried out in accordance with the approved scheme of prospecting. Mining operations in any area have to be in accordance with the approved mining plan. The Assessing Officer can always call for the approved mining plan to be able to determine whether there has been any illegal mining. Prospecting and mining operations are to be carried out in such a manner so as to ensure systematic development of mineral deposits, conservation of minerals and protection of the environment.

3.7 At times penalties are levied for non-fulfilment of these conditions. These penalties should be examined to determine whether they are allowable for tax purposes. The rules also specify certain returns that are required to be filed before the CGM. It would be useful to call for the returns filed by the mining companies. These would be a valuable source of information.

3.8 Further, a National Minerals Policy 2019 for non-fuel, non-coal minerals has also been announced by the Government of India. The full policy document is available online at www.mines.gov.in. This policy also aims to provide regulations regarding the minerals in India.

ALUMINIUM

4. ALUMINUM RESERVES

4.1 Aluminum is a versatile metal having many uses. Today it has come to replace steel in many industries due to its non-rusting quality and light weight. Aluminum has a variety of applications. It is the major input in key industries like power, aeronautics, transport and domestic appliances. It is also used in architectural fittings and in window and door frames, grain silos, industrial explosives and several defense requirements.

4.2 The major raw material for the production of aluminum is bauxite. India has the world's largest reserves of bauxite. The following companies are the major producers of alumina:

i. National Aluminum Co. Ltd.

ii. Hindustan Aluminum Corporation Ltd.

iii. Vedanta Ltd

iv. Indian Aluminum Co. Ltd. (Indal)

v. Bharat Aluminum Co. Ltd. (Balco)

vi. Madras Aluminum Co. Ltd.

Vast deposits of bauxite are found on the east coast region of the country in the states of Odisha and Andhra Pradesh. As per a report of http://www.careratings.com, in FY 2016–17, the Bauxite production in India was about 24.8 Million tonnes, Alumina was 6.1 milion tonnes & Aluminium was 2.8 million tonnes.

5. RAW MATERIALS FOR ALUMINUM

5.1 The main raw materials required for production of aluminium are-bauxite, power, caustic soda, calcined petroleum, coke, pitch, cryolite, aluminum fluoride fuel oil and coal. Around 100 kg of caustic soda is required for the digestion of bauxite to produce one tonne of alumina. Therefore, the norm of 0.2 tonne of caustic soda per tonne of aluminum has been adopted for working out the requirements of this raw material.

5.2 Power is a critical input for reduction of alumina into aluminium. It constitutes a significant component in the cost of aluminum production. On an average, every thousand tonne of aluminium ingot production requires about 2 MW of power.

5.3 Another important input is cryolite. The average norm of consumption is about 50 kg per tonne of aluminum. The aluminum producers recover cryolite from pot skimming for recycling. They also recover it from pot gases. Other important raw materials are aluminum fluoride (35 kg per tonne of aluminum produced) and carbon blocks. The Assessing Officer should verify the amounts of these raw materials used in order to assess the amount of aluminum production.

6. RECYCLING OF SCRAP

Over 90% of the new aluminum scrap generated in the production of end products is recycled almost immediately after it is generated. Scrap aluminum has great value. Even in early eighties recycled scrap accounted for as much as 37% of the production in Japan, 22% in the USA and 34% in Germany. With improved technology the percentage of scrap recovery is higher now. In India also the generated scrap is recycled fast. In

any tax investigation the purchase and disposal of scrap should be enquired into to determine the amount of scrap used in the production process.

CHROMITE

7. PROSPECTING

7.1 Chromite is an important alloying element in ferrous metallurgy. In this it is next in importance only to manganese. It is mainly found in the eastern parts of the country, notably in Cuttack district of Odisha and Khammam district of Andhra Pradesh, and also in Karnataka. The Geological Survey of India has also prospected for chromite in Ukhrul and Chandel districts of Manipur and in the Andaman and Nicobar Islands. The total reserves of chromite in India are estimated at 108 million tonnes. India is the third largest producer of chromite in the world.

7.2 In India, chromite is mined mostly by open cast method. The underground mines are only at Byrapur in Karnataka and Boula in Odisha. The maximum overburden to ore ratio is 15–1. Expenses in open cast mines are lower than those mines which are required to dig underground. One study reported that the cost of mining of chromite from open-cast mines was Rs 60 per tonne while it was Rs 150 per tonne for deep open-cast or underground mines.

7.3 The following companies are the principal producers of chromite in India:

i. Odisha Mining Corporation Ltd, Cuttack, Dhenkanal, Keonjhar, (Odisha).

ii. Tata Iron and Steel Co. Ltd, Cuttack (Odisha).

iii. Ferroalloys Corporation Ltd, Khamman (Andhra Pradesh).

iv. Balasore Alloys Ltd (Odisha).

v. Mysore Minerals Ltd, Hassan (Karnataka).

vi. Indian Metal and Ferro Alloys Ltd, Bangur and Phulbani districts (Odisha).

8. INDUSTRIAL USES

Chromite is mainly used in the manufacture of ferro-chrome and charge chrome which in turn are used for the production of alloy steel and stainless steel. Manufacture of refractories and chromium chemicals is the other principal application for chromite. Charge chrome normally contains 55–60% chromium and 6–8% carbon. Refractory bricks also use chromite as the main raw material. These materials withstand high temperatures of 2000 degree centigrade and above. Dense chromite brick containing 100% chromite are also manufactured. But generally refractory bricks contain silica and lime. The major firms manufacturing these bricks are:

i. Odisha Cements Ltd.

ii. Odisha Industries Ltd.

iii. TISCO.

iv. Belpahar Refractories.

v. Burn Standard Co. Ltd.

vi. Bhilai Refractories Ltd.

Chromite is also used in the manufacture of chemicals which in turn are used for pigments manufacture and treatment of leather and textiles.

9. TAX INVESTIGATIONS IN CHROMITE

Much of the Indian chrome is exported. In the case of an Indian company exporting chrome, the Assessing Officer detected under-invoicing of the export price. The export price according to the contract was $22 for chrome containing 50–53% chrome. The standard quality chrome normally has a 3–1 ratio of chrome to ferrous content. The ratio is an important factor determining the export price of chrome. This particular contract did not give any indication of the ratio of chrome to ferrous. This gave rise to suspicion. A search under Section 132 conducted in the premises of the company revealed that the assessee was receiving on-money from and on

behalf of the foreign buyers for these collusive and clandestine transactions. The assessee had obtained two sets of certificates of analysis from the chemical analyst. One certificate was attached with the shipping documents, while the real certificate was used to charge the on-money or secret premium which was not repatriated to India.

COAL AND LIGNITE

10. COAL PRODUCTION

10.1 Coal is the most important mineral produced in India. It accounts for nearly 70% of the total value of all the minerals produced in the country. Production of coal in 2016–17 was in 662.80 million metric tonnes. The main coal fields are in the Gondwana belt in the states of Bihar, Madhya Pradesh and Maharashtra. The tertiary coalfields are found in the states of Assam, Meghalaya and Nagaland. With the nationalisation of coalfields, the major producer of coal is the Coal India Ltd. which is the apex company having several subsidiaries like BCCL, CCL, WCL, ECL, NCL. These companies own several collieries in Bihar, Madhya Pradesh and in Maharashra. The Central Mine Planning and Design Institute Ltd. (CMPDI) is the think tank of the coal industry. Its headquarters are in Ranchi and it has branches at Asansol, Dhanbad and Nagpur.

10.2 Coal is produced from both open-cast as well as underground mines. The cost of production in open cast mines is cheaper than that produced by underground mines. Coal India Ltd. oversees the distribution of coal produced by its subsidiaries. Coal distribution is made by the Coal Controller, while there is no statutory control for the distribution of non-coking coal.

11. MAIN TYPES OF COAL

11.1 Lignite: This contains 25–40% moisture and disintegrates easily and is liable to spontaneous combustion. Hence its heat value is relatively less. Its color is brown to black. Lignite is normally made into briquettes commercially called 'Leco'.

11.2 Sub-bituminous Coal: This variety contains moisture ranging between 15–30%. It is black in colour. It is subject to spontaneous combustion, though to a lesser degree than lignite. Hence, it is mined commercially only for local use.

11.3 Bituminous Coal: This type of coal is usually black in colour. It weathers only slightly. It is normally kept in open piles with little danger of spontaneous combustion, if properly stored. It varies from medium to high rank. It may be of coking quality and produces coke when heated in a coke oven. The coking coal softens, swells and runs together when heated almost to its burning temperature. Further heating in a closed oven either without or with oxygen, the volatile matter is driven off in the form of gas, water vapour, light oil and tar. The remaining gray matter consists of fixed carbon. It is called coke and is extensively used in blast furnaces for the smelting of iron ore. Non-coking coal, though resembling coking type in appearance, burns freely. Residue from combustion is called charcoal. This type is preferred for the manufacture of cement because of its volatile content.

11.4 Hard Coal or Anthracite: This type of coal has a brilliant lustre. It can be polished and made into costume jewellery. It burns slowly with a pale blue flame and is used primarily for domestic fuel. It is sometimes blended with bituminous grades of coal to produce a mixture of improved coke used mainly for domestic consumption.

11.5 Soft Coke and Hard Coke: There are various kinds of soft coke. It is seen that the yield of soft coke is uniformly the same irrespective of the seam from which the coal is raised and whether the coal used is metallurgical or non-metallurgical. Generally speaking, the inferior the coal, the higher is the yield of coke.

11.6 Before use in blast furnaces coal has to be washed to remove the ash content. There are different grades of coal. The major grades are the following:

i. Steel grade-1 coal.
ii. Steel grade-2 coal.
iii. Washery grade-1 coal.
iv. Washery grade-2 coal.
v. Middling.
vi. Hard coke.
vii. Coal tar.
viii. Soft coke.

The grade of coal depends upon the ash content in the coal. The lower the ash content the higher the grade. The higher the grade, the greater the amount of heat that the coal is able to produce.

12. ACCOUNTING

Apart from the usual books of accounts that coal companies maintain such as cash book, ledger, journal, sales and purchase register, they are also required to keep certain statutory registers giving detailed information regarding the pits being exploited, the incline of the quarry, the grades of coal mined, stocks of coal, the amount of coal dispatched, wastage, etc. They send detailed monthly statements on such matters to authorities particularly the Controller of Coal. The Assessing Officer should call for the statements and compare them with the disclosed facts.

13. TAX INVESTIGATIONS IN COAL & LIGNITE

13.1 Removal of Overburden: When the seam of coal is close to the earth's surface, coal is extracted by quarry after removing the superficial layer of earth. This is technically known as overburden. Expenses under this head should be carefully scrutinized to make sure that no part of expenditure on prospecting, exploring or developing is included in it. The following particulars should be obtained in respect of such expenses-

Thickness of the overburden, length and breadth of overburden removed, measurement of overburden removed in terms of cubic feet, and the rates of wages paid for removing the overburden. Much of this work is often subcontracted.

Usually a part of the income is diverted, by being shown as contract expenses paid for this work. On several occasions it has been noticed that this work has been awarded to the nominees of the owner thereby diverting a portion of his income. One way of checking the amount paid on this account would be to call for the daily register of the number of trips made by the trucks employed. This would give the Assessing Officer an idea of the quantity of the overburden lifted.

13.2 Coal Consumed in Collieries: A substantial amount of coal is used in collieries as fuel for boilers or for free distribution among the employees and labourers. Colliery owners are required to give figures of colliery and boiler consumption in monthly returns to the Mining Department. In order to arrive at the amount of coal being consumed, it would be worthwhile examining the number of boilers used and the number of shifts that these boilers were put to use. The number of boilers being used can be cross-verified from the statement sent to the Chief Inspector of Boilers. The register detailing the attendance of the boiler attendants will also give some indication of the number of hours that the boilers were in operation. The reasonableness of the free supply of coal to labourers should also be looked into. In cases where the supply of free coal is excessive, the question of the perquisite value could also be considered, especially in the case of the senior managers.

13.3 Rejections: In the process of mining, a certain amount of coal is bound to be rejected as containing impurities. The rate of rejection

is normally 1–1.5%. Some of these rejects are also sold as inferior grade coal. The Assessing Officer would do well to examine the amount of rejection and, should it be excessive, cross-verify the facts with the Coal Board.

13.4 Depreciation: The major heads of expenditure in coal mines are the following:

Expenditure on Wasting Assets (Capital): This type of expenditure is on operations that are necessary for the operation of the mine, *viz.* shafts, inclines and mains for the purpose of opening a seam to mine new blocks of coal or to make connections with other outlets.

Expenditure on fixed assets like plant, machinery and furniture.

Expenditure on operations incidental to the main activity such as main driving, side dressing, drain cutting and quarry cutting.

Normally depreciation on wasting assets is not permissible and should be restricted only to shafts and inclines. Although these are wasting assets, it has been the practice in the past to allow depreciation on them. The existing practice may be continued but no depreciation should be allowed on 'mains' or other types of wasting assets. As regards plant, machinery and furniture, the treatment accorded under the Income-tax law is the same as in any other business case.

13.5 Expense Accounts: The main items of expenditure incurred by collieries are in the nature of salary, bonus, provident fund contribution, wages, truck and wagon loading, screening, purchase of soft coke, washery expenses, stores and repairs, replacements of tram lines tubes wire ropes and various cess and taxes. It is necessary to scrutinise some of this expenditure since several items of capital nature are usually debited to the trading colliery account.

13.6 Salary and Wages: The salary of various grades of employees is fixed by the Coal Tribunal which looks into the total remuneration being paid to the miners. The payment of bonus and provident fund is governed by the Coal Mines Provident Fund and Bonus Schemes Act. Colliery owners have to submit various returns to authorities appointed under the Act which are verified by the concerned Inspectors periodically. The Assessing Officer would do well to call for these reports in order to detect any irregularities for which penal amount would be levied. These would be debited to the accounts of the colliery. In a certain case, the mining operations were suspended for a long period, but the assessee continued to claim wages paid as ex-gratia payments. This claim was disallowed by the Assessing Officer since, in the business of mining, the normal practice is to make wage payments on piece-rate basis.

FIRE CLAY

14. THE INDUSTRY

14.1 Fireclay is a refractory material. It usually occurs as a bedded deposit mostly associated with coal in the Gondwana region. Important deposits are found in the Jharia and Raniganj coalfields in Bihar, in the Korba coalfield in Madhya Pradesh and Neyveli lignite coalfield in TamilNadu. The total reserves of fireclay are estimated at 722.83 million tonnes. There are several small producers of fireclay. Practically all the mines of fireclay are worked in an open cast bench system. Fireclay is mainly consumed in the refractory industry. Fireclay bricks are manufactured to meet different heat insulation requirements. These bricks are used in all major industries like iron and steel, cement, ferroalloys, foundries and glass. The other uses of fireclay are in the ceramic and sanitary ware products. An important issue from the tax angle is to remember that fireclay is recovered from coal beds. Often colliery owners would claim that the debris is rejected. Rather much of the coal debris contains minerals such as fireclay which has commercial value.

IRON ORE

15. THE INDUSTRY

15.1 India is the fifth largest producer of iron ore. The leading producer of iron ore is Goa, followed by Karnataka. In Karnataka, the major producer is the public sector company Kudremukh Iron Ore Co. Ltd. Most of the iron ore mines are open cast mines both in Goa and Karnataka.

15.2 There are basically two types of ore-a) magnetite, and b) hematite. In magnetite, the ferrous (iron) content is around 38%. In hematite, it is between 62 and 65%. Export ore should have between 45 and 50% ferrous content. Iron ore is mined by blasting seams of rock containing a minimum level of ferrous content. This ore is shovelled onto 50 tonne dumper to the crusher. Following processes are carried out before the ore is ready for marketing:

i. Crushing.

ii. Screening.

iii. Washing.

iv. Beneficiation.

v. Agglomeration.

Crushing and screening are done to remove the clay and limonite matter and to improve the grade. Most of these are mechanical processes.

15.3 In Kudremukh the magnetite concentrate in slurry form is transported though a pipe line to Mangalore port. In Goa, the iron ore extracted from the mines is transported to the river head on barges. It is then loaded on to ships chartered by the buyers.

16. TAX INVESTIGATIONS IN IRON ORE

16.1 Examination of Consumption of Raw Materials: Dynamite and other explosives are used for cutting seams of rock. Explosives are generally accounted for. However, there have been instances of inflation of expenses under this head. Several chemicals and additives are added during the processing of the ore. All companies keep an account of these chemicals. The primary registers should be specifically called for and examined.

16.2 Capital *vs.* Revenue Expenditure: In the mines, sometimes semi-permanent or temporary structures are erected. This is common in the mines where access is restricted. A substantial part of this expenditure may be of capital nature. Claims for revenue deduction of such expenditure should be identified and denied.

16.3 Need to Look into Ferrous Content: A copy of the chemical analysis report of the ore being exported should be called for. This would indicate the ferrous content of the ore being exported. This ferrous content should also be indicated in the export documents. Samples of iron ore being exported is first tested in the laboratory to determine the ferrous content. There is often a manipulation in these reports to record a lower content of ferrous and thereby to undervalue the quality of the iron ore being exported. Thus, while the laboratory report in India of a sample may show a ferrous content of 53–58%, that in Japan or Korea may record 60–63%. As the price is fixed with reference to the ferrous content, there will be an excess over the declared export price. This difference in price is usually collected abroad clandestinely. If the ferrous content of the two documents vary, an explanation should invariably be called for to examine any under-invoicing.

16.4 Short Weighment: Before shipment, the ore is weighed and the tonnage is certified by the captain of the ship. This certificate is used by the auditors to certify the amount of ore that has been exported. Some instances of under-

weighment have been noticed. It has been reported that ships carrying 1 lakh tonnes of ore are certified as carrying only 90,000 tonnes while 10,000 tonnes are being paid for outside the books. The price for the ore not shown in the weighment report is then paid to the mine owners outside the books, probably abroad.

16.5 Forest and Ecology Expenses: They are claimed as revenue expenditure but are often seen to be capital in content. They should be scrutinised for the kind of benefit they brought to the assessee.

16.6 Provisions: Often one comes across provisions made for non-performing assets or doubtful recoveries. Full facts regarding these provisions should be ascertained and the claim carefully examined.

17. COPPER

17.1 Copper is an important mineral. It has several industrial and commercial uses. In India it is mined by the Hindustan Copper Ltd., a public sector concern. The domestic production of around 5000 tonnes is not sufficient to meet indigenous demand requiring import of the metal, which is channelled through the Metal and Minerals Trading Corporation Ltd. Reserves of copper in India are placed at 324 million tonnes equivalent of 3.4 million tonnes of metal content. Copper is a scarce mineral in India. Its high price has restricted its use to mainly electrical and technological uses.

17.2 Mining and milling of the copper mined is undertaken at Khetri copper complex in Rajasthan and at the Indian Copper Complex (ICC) at Ghatshila in Singbhum district in Bihar. Copper ore or slag has to be treated in order to obtain copper concentrate. Copper ore is formed into concentrates and then these concentrates are sent to smelting plants which produce copper wires or cathodes according to specification.

MICA

18. THE INDUSTRY

18.1 Mica is a non-metaliferrous element generally found in underground deposits. There are two distinct types of mica namely-muscovite and phlogopite which have important commercial uses in the electric and electronic industry. There has been a gradual decline of mica production in the country due to the non-remunerative and unscientific methods of mining. Around half of the mica mining in India is in Bihar. The other leading states are Andhra Pradesh and Rajasthan. Mica is found in systematic deposits like ferrous ores. Rather the deposits are mainly in between the layers of stones known as pegmatites. Thus, mica mining is erratic and cannot be carried out in accordance with an assay plan like ferrous ores. In view of the nature of mica, it is not possible to determine the exact amount of mica that would be available at any given site. There is no scientific formula. Miners look to the nature of the soil and stones to determine the quantity of mica by trial and error method. Small pits called '*uperchalla*' are dug to ascertain the nature of stone and sand in the region and to determine the location of the mica veins.

18.2 Mica is a first-rate electrical insulator. It is immensely valued as an ideal insulator in electrical and electronic equipment and appliances. Another property of mica is that it is not affected by acids or alkalis. It is a very special property not possessed by any other material, natural or substitute. Mica is used in two different forms:

i. Sheet mica which includes block, film and splitting,

ii. Scrap and flake.

The two forms have completely different patterns of consumption and trade.

19. TAX INVESTIGATIONS IN MICA

19.1 Raising Contractors: The mica mine owner normally sublets his mines to a Raising contractor. Certain parts of the expenses for mining such as the cost of explosives are usually met by the mine owners. A stock register is required to be maintained by the contractor. This register indicates the quantity of ore which has been mined. The 'raised' mica is sold by the contractor. He pays a commission that may range between 15–25% to the mine owner. The net after this commission is the income of the contractor. Instances have been detected where the mine owner has suppressed or understated the amount of commission received by him. It may be that a part of the commission is paid in cash and goes unrecorded. If the commission receipt is shown at less than the above range, there is something amiss. Then, it would be worthwhile to investigate the case. A stock register is required to be maintained by the contractor. This register indicates the quantity of ore which has been mined. The register will help investigations a great deal.

19.2 Collusive Arrangements: There may be a collusive arrangement between the raising contractor and the mine owner to suppress actual production figures and to inflate expenses. This production is then sold off outside the books. The explosives used are required to be accounted for and a statutory register maintained. This register is subject to scrutiny by the Inspectorate of Explosives. The Assessing Officer should verify the register in order to have some idea of the amount of mica produced. Another line of verification would be to verify the labour register, in order to determine the number of labourers employed. Very often there is an inflation of expenses under this head. Sometimes it may be that the mine owner himself is extracting mica, but claims that the work is being carried out by a raising contractor. This he does in order to divert a part of the profits.

19.3 Inflation of Wages: Mica once mined is sorted and dressed. Crude mica is generally cut and shaped by unskilled labor. It is then split and sold in suitable sizes. Thick mica termed as block mica contains several layers. When these layers are split, they are called films or condensers. The gradation of mica is on the basis of the size of mica. The quality of the grades depends upon the clearness of the mica. The labour charges for splitting of mica are based on weighment. There are registers maintained for this purpose and they could be verified in cases of doubt.

19.4 Costing in the Case of Mica Mining: Mining of mica is a labour-intensive process. Further, intensive labour is also used in grading and sorting of mica. Each mine owner is required to submit an annual return of the mica mined. There is a great deal of suppression of the mica production figures. Government reports state that about 30% of the mica mined is not reported. Mica is also exported with the rates of mica exported depending upon the quality and the grade of mica. It would do well to call for a copy of the export documents to verify the rates of mica that are being exported.

19.5 Wastage and Shortages: The percentage of cut mica got from crude mica is only around 10–15. Therefore, around 85–90% is sold as waste or scrap. These rejects are also saleable. Further, in the process of cutting, there is a certain amount of shortage. The reasonableness of this shortage should be examined.

19.6 Revenue *vs.* Capital Expenditure: The question of revenue and capital expenditure in mica mining has been considered by the CBR (Central Board of Revenue) in Circular No 32 of 1940 dated 25th March 1940.

Mica mining had special features of its own unlike other important minerals. Mica occurs in small deposits which are scattered in great profusion and are readily accessible from the surface. This surface mining which is locally termed as 'upperchella' is often done through contractors who are paid according to the quantity and quality of mica produced by them. Whether the work is done through contractors or through the mica owner's own labour, the whole expenditure should be treated as ordinary revenue expenditure. The expenditure on shafts, audits and inclines whether permanent or temporary is of a capital nature. But expenditure incurred in underground mining called 'progression' should be regarded as revenue expenditure irrespective of the fact whether it is productive or unproductive provided that it is for working in the vein. If, however, the vein is lost, the expenditure incurred in reaching another vein will be of capital nature. The cost of the ordinary survey staff for keeping plans of the mines etc. should be treated as a maintenance charge and not as capital expenditure on prospecting.

These Instructions of the Board although fairly old are still relevant.

19.7 Royalty and Dead Rent: Royalty payment made on excavation of mica is paid for acquisition of the source of income and hence capital in nature. However, the question of capital or revenue depends upon the facts of each particular case. In the case of a mica mining company wherein mining rights were acquired under agreements requiring payment of money under instalment for a period ranging from 5 to 9 years, it was held that payments were capital expenditure and not deductible. Similarly, expenses incurred for prospecting are of capital nature. Special deductions are permissible in respect of prospecting business under the Income-tax Act.

19.8 Dealers: Like raising contractors and mine owners, dealers in mica are also required to obtain licenses from the government for dealing in mica. A list of the dealers would be available with the local authorities. Dealers purchase mica from other dealers or from mine owners. Very often dealers resort to inflation of purchases. This could be cross verified from the Inspector of Mica Accounts, since all transaction regarding purchase and sale of mica has to be recorded.

MANGANESE ORE

20. THE INDUSTRY

20.1 Manganese ore is another important mineral in India. Odisha is the state leading in its production in the country. It is followed by Madhya Pradesh, Maharashtra and Karnataka.

20.2 There are three types of mines, namely:

i. Boulder or chilli mine,

ii. Dump mines, and

iii. Reef (open cast) mines.

In open-cast reef mines, the ore body is exposed by removing the overburden, the top soil. This process of removal of the overburden is called 'development'. Similar development work is required to be undertaken in boulder and chilli mines. Development work in the case of underground mines takes the form of sinking shafts, cutting galleries and making approaches to the ore body. Reefs of manganese lie at various depths from the surface and follow all conceivable angles, turns and twists. Underground excavation is undertaken only if the reef is rich in ore. Open cast mines development work requires the cutting of 'benches' or 'terraces' five feet in width and height. The deeper the reef goes the greater the development cost.

20.3 Grades of Manganese Ore: Manganese ore is classified into various grades depending upon the content of the mineral. Grade-1 has manganese content of 48% and above. Grade-2 has manganese of 46–48%. Grade 3 has manganese of 44–46%, while Grade-4 has manganese content of 40–44%. The better the grade, the greater the profitability.

21. TAX INVESTIGATIONS IN MANGANESE ORE

21.1 Manganese dealers show gross profit ratios of around 25%. Depending on the market conditions, the gross profit ratio could be as high as 40%.

21.2 Shortages: Shortage of manganese stock has to be taken into consideration. While there is no scope for pilferage, shortage can take place at the following stages:

i. In ore-dressing, the inferior grade ore or gangue is eliminated;

ii. During weighment certain stock difference is sometimes noted; and

iii. Certain shortage occurs during transit.

Shortage is only a small percentage of the total stock. In cases of wide variations, this aspect should be examined carefully.

21.3 Stock Valuation: Although governmental regulation prescribes various stock statement that are required to be maintained, mineral stocks are very often undervalued. In certain cases stocks in transit at railheads, docks or in trans-shipment are not taken into account. Further, there is often a manipulation of the value of the grades and the quantity of the ore. It has been noticed that in a certain case, some grades of manganese ore were deliberately suppressed. Sometimes certain stocks of ore are claimed as wastage and not reported, but are later sold as inferior grades of manganese. A look at the closing stock of the previous year and a comparison with the opening stock of the financial year would be useful to ensure that all the stock of the previous year has been duly accounted for.

21.4 Extraction Expenses: Manganese extraction entails a huge outlay giving scope for inflation of expenses. Normally much of the excavation work is subcontracted to Raising contractors. In many instances it was noticed that these contractors are relatives of the mine owners. In certain cases, inquiries revealed that the staff members of the mine owner including technical staff members such as chemists and engineers were also shown on the books of the raising contractor. In suspicious cases, it may be useful if the contracts between the mine owners and their contractors are perused and the nature of the payments made to these contractors is ascertained.

22. COMMON TAX ISSUES IN THE MINING SECTOR

22.1 Claim of Capital Expenses as Revenue

i. **Land Compensation and Rehabilitation Expenses:** A company had claimed an expenditure of Rs. 134 crores representing the payment made to the State Government to acquire surface right as well as the right to possession in respect of lease hold land for a longer period as well as for incurring expenditure pertaining to the rehabilitation of people in the course of obtaining the use of land for mining purposes as a revenue expenditure. The assessee stated that The company claimed the expenditure to be of revenue in nature since the company has not become the owner of the land but merely obtained the right to mine coal situated in that area.

Relying upon decision of courts (Hon'ble ITAT, Nagpur Bench in the appellant's own case in ITA Nos. 18 to 22/ Nag/ 2011 dated 28–02–2002 for the Asstt. Yrs. 1989–90, 1990–91, 1994–95, 1995–96 & 1996–97 and Hon'ble Supreme Court in the case of *Saurastra Cement Limited vs. CIT* 192 Taxmann 300 (SC); *Sitalpur Sugar Works vs. CIT* (1963)49 ITR 160 (SC) and Hon'ble High Court's decision in the case of *International Airport Authority of India vs. CIT* (2002) 254 ITR 657 (Delhi), *Hardillia Chemicals Ltd. vs. CIT* (1996) 218 ITR 598 (Bom), *Jaganmohan Rao vs. CIT/ EPT* (1970) 75 ITR 373 (SC)) treating such expenses as capital, Assessing Officer disallowed Rs. 3148.51 lakhs on land compensation and rehabilitation expenses being a capital expenditure and added it back to the returned income. Right to possession in respect of leasehold land for enduring period was a capital expenditure.

ii. **Liquidated Damages:** The assessee was engaged in the business of screening iron ore and sale of iron ore. The assessee entered into agreement with the owners of a mining concession of iron ore, for raising iron ore from the mines. The assessee did not operate the said mines in the previous year relevant to the assessment years in question. In its assessment for the relevant assessment year, the assessee claimed deduction of liquidated damages paid to owner of one of the mines for non-operation of the mines in the previous year. The Assessing Officer rejected the claim of the assessee for deduction on the ground that the payment was of capital nature. Hon'ble High Court upheld this opinion of Assessing Officer in *Salgaonkar Mining Industries* (1997) 228 ITR 183 (BOM.).

iii. **Damages Levied on Suppliers:** Mining companies are big corporations and are often in a position to dictate terms. In one case, the company claimed liquidated damages amounting to Rs. 380 crore as capital receipts. Facts were that due to late supply of plant and machinery the assessee had imposed penalty on certain suppliers. Though in profit and loss account, this was offered as income from other sources but reference to the computation of income revealed that out of total of such receipts the assessee had reversed a sum as being capital in nature. Since the penalty assessee received was the amount on belated supply of machineries and the amount of penalty had no long term implication, the amount was added as revenue receipts. It was also confirmed in first appeal.

22.2 Claim of Provisions in P&L Account

A sum of Rs. 24 crore was claimed as provision for mine closure. The AO observed that by the guidelines, the Mining Ministry, GOI created a set of norms to set up a fund so that mining companies especially the private one do not fly by as soon as the mines get exhausted without taking its share of financial burden of mines closure process, that the fund created as per this norm would be used some times in an indefinite future, if at all, at the time of mine closure and that the fund was supposed to be built up for eventuality, that there was neither any specific expense to be incurred nor any specific time frame could be identified and therefore, financial liability on account of mine closure is clearly unascertainable. The guidelines indicates that ownership of fund so created rests with the

companies itself and that the said fund would be used only to the extent of requirement and therefore, the mining companies will be able to enjoy the balance left in that account. The provisions for mine closure relates to a number of years, that it is basically a cumulative figure representing claims related to various past years and as per provisions of the Act, such claim pertaining to prior period are not allowable unless it is proved to have been crystallized in the year of claim. In case of the appellant, question of crystallization does not arise at all. It is altogether a new concept floated by the Ministry of Coal and it is not an allowable expenditure on two grounds, firstly, only a fraction of total provisions under this head is relatable to the current year and secondly, the claim in its entirety is nothing but a mere provision and IT Act does not allow claim of any provision. Assessee-company was asked to state the amount of expense actually incurred under this head during the year under consideration. In reply, it was stated that the provision was created as per the guidelines of Ministry of Coal and the provision relates to the year under reference only. A detailed computation of provision for mines closure was enclosed in Annexure-1 of the reply.

The AO verified the reply and the Annexure-1 and found that Escrow Account as advised by the Ministry was yet to be created and thus, impugned sum of Rs. 24 crore was neither created nor set-aside during the year. The amount was therefore disallowed. The reasoning is that a 'provision' is a liability which can be measured only by using a substantial degree of estimation. It is recognised when an enterprise has a present obligation as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation and reliable estimate can be made on amount of the obligation. If these conditions are not met, no provision can be recognised. Assessing Officer Relied on *Rotork Controls India Pvt. Ltd.* 23 DTR 79 (SC). The Hon'ble Apex Court in case of *Bharat Earth Movers Limited vs. CIT has held, "The law is settled: if a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied, the liability is not a contingent one. The liability is in present though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain……".*

In another case, assessee was engaged in the business of turnkey projects, in which, time was the essence of contract, and one of the conditions enumerated in the contract was delivery of equipment in time, which if not done within the stipulated time, would lead to liquidated damages. Assessee's case was that during relevant year there was delay in delivery of machinery and, thus, liability to pay liquidated damages arose. The assessee claimed deduction of liquidated damages under Section 37(1). Documents placed before the Court showed that there had been negotiations, discussions before the liquidated damages was arrived at, which was much after the subject assessment year. These documents were held to be strengthening the case of the revenue and the findings rendered by the Commissioner (Appeals) as well as the Tribunal, which had held that there is no ascertained liability. The case law is *FFE Minerals India (P.) Ltd* (2018) 98 taxmann.com 170 (Madras).

22.3 Claim of Overburden Removal Expenses

In one case, a sum of Rs. 714 crores was claimed on account of expenditure on overburden removal adjustment. Mining companies follow a term 'stripping ratio' which is as below:

$$\text{Average Strip-Ratio} = \frac{\text{Total OBR to be removed from life of the quarry (in cu.M)}}{\text{Total mineable coal reserve in the quarry (in tones)}}$$

This ratio is against the language of Section 35E of I.T. Act which stipulates certain capital expenditures for amortization. The proviso to Sub-section (2) clearly states that any portion of expenditure shall be excluded thereof which is met directly or indirectly by any other person or authority and any sale salvage compensation or insurance money realized by the assessee in respect of any property or right brought into existence as a result of the expenditure. Sub-Section (3) further lays down the limitation for amortization, Sub-section (4) of Section 35E prescribed 1/10th of the expenditure incurred by the assessee after the date specified in the Sub-section at any time during the year of commercial production and any one or more the four years immediately preceding that year wholly and exclusively on any operations relating to prospecting for any mineral or on the development of a mine or other natural deposit of any such mineral. Sub-section (5) defines operation relating to prospecting and year of production and the relevant previous year.

The ratio followed by the assessee was not found by Assessing Officer in accordance to the Section 35E of I.T. Act on three counts. Firstly, the mining in the depth was not mine development and so the expenditure could not be clubbed with mine development. Secondly, the over burden removal which was stated by the assessee was quantified with the capacity of the mine and when the amortization ended for earlier four years or just before the commercial production of the coal there was no clue with the assessee by following this ratio. Thirdly, the Ministry of Coal had undertaken to compensate the assessee for over burden removal like filling of the pits from which the coal had been extracted, thus, proviso under Sub-section (2) of Section 35E was invoked which states that such portion of expenditure shall be excluded which is met directly or indirectly by any other person or authority. The assessee was taking the amount of such accrued reimbursable amount by the Ministry of Coal in the Balance Seet which was not proper and should have been adjusted against the over-burden removal. Since the issue had been agitated for quite a long period and the assessee had been cleverly taking the expenditure which is met, directly or indirectly, by the Ministry to the Balance Sheet itself and debiting the whole amount in the P&L A/ c is not correct.

Assesses do not keep record to state the exact amount of amortization of preproduction period. In such cases, the claim should be disallowed.

22.4 Expenses Related to Ancillary Works of Mining Companies

Mining area is a large area and involves several villages. Also there is large staff and dedicated colonies which are developed and owned by mining companies. Sometimes facilities of schools and hospital are created by other persons and mining companies provide assistance in the interest of employees and families of employees. The expenses on these activities need to be examined.

22.5 Claim of Depreciation on Hospital Building

Building owned by the company, was given to a hospital group for running the hospital

project mainly meant for welfare of employee of the appellant. The agreement entered into in this behalf entitled the assessee to refer all its employees and their dependent for specialized treatment in this hospital and it received rent for the hospital building. Assessee claimed depreciation on the hospital building which was disallowed. The assessee's claim was based on the ground that the building on which rent is received by the company is wholly and exclusively for the purpose of business of the company. It meant that the building was owned by the assessee and rent is also received by the assessee. The rent could be income from other sources or from the house property income. If the assessee claimed that rent was received by the assessee for the building, since rental activity was not the business of the assessee, merely giving the building could not make the building as 'plant and machinery'. Hence, no depreciation was allowable on the house property income. The addition was confirmed in first appeal.

22.6 Grants Made to Schools

A sum of Rs. 34 crores was claimed by the assessee on account of grants to schools and institutions. The Assessing Officer quoted the replies of the assessee-company and from its submission, he observed that Central Schools and DAV Public Schools are premier institutions having their own management, set up and source of funds and the schools are not exclusively meant for the children of the appellant's employees. The assessee had no control over the management. It made a lump-sum payment to school every year and such payments were in no way related to number of children of the appellant employees. No proof could be adduced to establish that the impugned expenditure was in the form of reimbursement of proportionate expenditure met for running the school. It was also not understood as to why education had to be subsidized for the employees most of whom drew a comfortable pay-pack and were reasonably well placed financially.

Further, the Assessing Officer observed that the facilities provided to the employees were in the nature of perquisites required to be taxed in the hands of the employees separately. This was not been done and therefore, the revenue was a loser on both counts. First, expenses were claimed as deduction and second, these were not treated as taxable perquisites in the hands of the employees. From the budget estimate of DAV Public School, he observed that comparison of number of children belonging to the employees *viz-á-viz* those from outside was given for F.Y. 2008–09 and no such details for relevant period were produced, that much less than 50% students belonged to the employees of the appellant, that over the years fresh induction into the services was on a steady decline and as a result, it could be reasonably expected that in F.Y. 2010–11 there would be fewer students belonging to the employees for admission and that same would be true not only for Bilaspur, but for other stations also. Under such circumstances, for Assessing Officer, mammoth expenditure of Rs. 2910.96 lakhs appeared to be unreasonable, being superfluous and steep rise in the expenditure every year under this head only confirmed negative tests as pointed out in the case of *Navsari Cotton & Silk Mills* 135 ITR 546 (Guj). Assessing Officer also relied upon case of *P.A. Jose vs. ITO* 35 taxmann. com 181 (Coch) to hold that the expenses were superfluous aimed at lowering of tax liability & thus, added Rs. 2910.96/- lakhs back to the income of the appellant.

22.7 Expenses on Power and Fuel on Employees

Assessing Officer had disallowed a sum of Rs. 92 crore incurred by the assessee on account of power and fuel being 50% of the total

such expenditure. The assessee-company submitted that the power consumed under "Social Overhead" represented total power consumed by the company in its residential accommodation and general services. General services represented township lighting, street lighting, hospitals and dispensaries, schools and educational institutions maintained by the company, pump houses crèche and canteens, clubs etc. Therefore, the entire power shown under Social Overhead was not only for residential accommodation. Though electric meters were not installed in the residential quarters, yet 1% of basic salary/ wages was recovered from every employee as per NCWA. It was also stated by the company that the matter of setting up of electric meters at each residential unit of the company in spite of several discussions with the power houses, stood unresolved as the power houses had stated that it would not be feasible for them to read the meters situated at remote places in absence of definite manpower, that the deduction made towards electricity was out of an agreement and thus, whether such deduction was adequate or not remained unsettled in the absence of meter, the deduction was designed scientifically based on the power points installed in the type of residential quarters.

The Assessing Officer observed that providing electricity to all the staff was a big leakage having no business expediency. Also, he observed that the issue of not providing electric meters at the residential accommodation was a matter related to issue of perquisites and could not be subject matter of assessment under Section 143(3) of the Act, that when the employees were well placed with good pay package such a subsidy was superfluous & lowered tax liability and that similar disallowance were made in previous and subsequent years till the A.Y. 2010–11 though allowed by the First Appellate Authority in previous years.

22.8 Claim of Expenses on CSR

Assessee incurred expenses on corporate social responsibility amounting to Rs. 43 Crores. It was explained that such expenses are borne by the Company for the development of nearby areas of coalfields as per the guidelines of Department of Public Enterprises, Government of India. The expenditure was incurred on the welfare activities of these areas namely, repair of roads, tubewells and wells, running and management of primary dispensary, provision of drinking water, widening of drainage system, widening of roads for easy movement of vehicles, street light etc. It was stated by assessee that many employees of the company resided in their own residences in the nearby areas as such the expenditure was primarily in the nature of staff welfare as the benefit of the expenditure ensued to the employees of the Company who resided in such communities and villages. Additionally, the villages and communities being located in adjoining coalfields areas of the company suffered environmentally due to mining of coal. As a result there was resentment among these people. The company therefore, stated to have incurred this expenditure in order to prevent any unrest among the local people and to maintain peace and harmony to be able to continue with its business operations smoothly. As per the assessee, the expenditure was aimed to (1) enhance its brand image and reputation, (2) better financial prospects through development of local community, (3) increase customers loyalty and sales, (4) increase the ability to attract and retain workers as well availability of cheap local workers, (5) a reduced regulatory/ activities' oversight, (6) reduce risk and (7) reduce its operating costs through creation of local human resources, thereby facilitating easier finance or access to capital.

There is no doubt that by undertaking CSR activities the corporate gains more profit, benefit, and legitimacy all at once. It is obvious that CSR is one of the tools to increase corporate power in the society. Numerous big corporations have increased the resources they devote to CSR in order to gain legitimacy and higher profit, simultaneously. In particular, the 'license to operate' from the company's host environment and community is as important as the company's financial resources. This investment finds its returns in the form of helping the company avoid the cost of compensating the community affected by its operation. These agenda have been acknowledged explicitly by the CSR advocates, including in business and academic circles. It is targeted to access easy & economic resources at convenient places by pacifying the anger of the displaced and dispossessed people against the corporate. Activities under this head are targeted to project a good image of the corporate. Manifestly, such expenses can never be allowed as revenue item.

Government has made CSR activities mandatory. It is not that companies have been incurring these expenses prior to the government's dictate. This shows that the expenses is not related to business and is in accordance with govt's dictate. Some assessees claim that the expenditure incurred by the company on CSR activities is out of Government directives and policies formulated by the government itself and therefore, a business expenditure of the company. Some assessee also contended that before CSR expenditure was made mandatory by the government, the company used to incur similar expenditure for the community development. Despite all the above claims and contentions, the fact is that CSR expenses are to be made out of assessee's profit after tax and should not be charged to the income before taxes. *With effect from* 01/04/2015, *Explanation-2 to Section 37(1)* has been inserted in I.T. Act 1961 & it makes it clear that CSR expenses shall not be allowed as incurred for purposes of business & profession.

Even before insertion of this Explanation-2 under Section 37(1), one of the case laws in favour of Department on such issues of community development & CSR is *Wipro Ltd. (2014) 41 taxmann.com 190 (Karnataka)*.

22.9 Besides the above, the AO should also examine various other expenses under different nomenclature such as *environment expenses, sustainable development expenses, tree plantation expenses, land crop compensation, coal/ iron/ ore transportation expenses,* to see if no undue claim has been made.

23. RECENT INVESTIGATIONS

23.1 In recent search & seizure actions in Karnataka & Goa region, mining entities were found engaged in large scale under-invoicing of iron ore exports. Various trust and company structures with benami Directors were found incorporated in tax havens like British Virgin Island (BVI), Singapore etc.

It was found that the iron ore which was being exported to China at a higher actual rate was being disguised as being sold to the concerns in Hongkong at a cheaper price. These Hongkong based concerns were being shown as independent purchasers, however, the search action proved that these were front companies of the Group, with an ex-accountant of the group and another family friend as Directors.

23.2 Suggested lines of inquiries for investigation:

a. Extensively use various online sources of foreign countries *viz* registry of companies, land registry etc. along with methods of non-intrusive surveillance techniques to get information.

b. Serious study of intelligence related to foreign assets which CBDT sends regularly to field formations in the form of dissemination of information received from foreign jurisdictions e.g. Japan, China, Sweden etc. under Tax Information Exchange Agreements (TIEA) and making FT & TR references.

c. Comparison of prices with similarly placed companies/ entities can also be done to arrive at scale of tax evasion.

d. Seized/ impounded digital data to be analyzed thoroughly.

24. CONCLUSION

India is a mineral-rich country. There are many other minerals which are mined here. Only the important ones have been discussed above. The mines yielding other minerals follow mostly the same techniques for mining. Hence, the issues discussed here hold good for them also.

The traditional investigation of verification of capital invested in new project, overstatement of cost of project, understatement of production of mining etc. are common modus operandi of tax evasion in this sector. The running of mines under a Benami name is still a common phenomenon. Assessing Officers should refer such cases to the Benami Unit of the department.

Now in place of Sales tax, excise duty etc., the GST (Goods & Service Tax) is applicable. There are different GST rates on various minerals. While investigating the mineral firm engaged in mining/ processing, the Assessing Officer should get details of GST paid by the assessee which will provide input regarding quality and quantity of mineral products sold by the assessee. Also, the e-way bills generated in the case of the assessee can be examined to comprehend the total turnover.

The use of satellite picture/ images/ data may help in investigation in mining sector regarding extraction from particular site between the particular periods. In the modern technology based era, the Assessing Officer can seek help of Google Earth to see the map of mine sites in order to verify the claim of the assessee regarding mining activities carried by it at particular site. This can be of tremendous help as the maps also show the position back in time. Ordinarily, the Assessing Officer is required to investigate the events/ position of the past. Thus,the internet, esp. Google Maps can be of immense help in this regard. It can also help to verify whether any illegal mining activities were carried out in that particular area under the control of the assessee, of which the assessee would naturally have been the beneficiary. By Google Earth mapping, we can get the mining status and data of particular date of earlier years and we can compare the relevant volume of mining. The RSA (Remote Sensing Area) of ISRO (Indian Space Research Organisation) can also provide official data for particular sites/ area. The Assessing Officers should explore seeking information from this organisation.

It is a normal practice in the mining industry that sale is suppressed by way of managing lower quality of minerals in the bills raised to avoid GST and Royalty. Normally, the money is paid in advance for purchase of goods and shown as creditors for long time in the books.

It is also a common practice that the bank accounts are opened in the name of the employees and the goods sold outside the books of accounts (or cash portion of suppressed sales in books) and cash received from the customers is deposited directly in these *benami* accounts. The cash is deposited by the customers in these bank accounts throughout India.

The state imposes royalty on all products taken out of the mines. Assessing Officers can collect information from the state mining department to cross-check production shown.

The Controller of Mines and Leases, Nagpur is the authority to grant mining lease. It is a repository of information and an Assessing Officer can seek details of projected excavation and compare the same with actuals shown by assessees.

In the mining sector, the profit ratio is high and there is a tendency to shift the profit to associate concerns. The Assessing Officers may consider the applicability of Arm's Length price provisions in domestic as well as international transactions to determine the real profits of the assessee.

CHAPTER

2

Granite Industry

1. INTRODUCTION

1.1 India has one of the highest granite reserves in the world. With more than 110 shades, India accounts for over 20 Per cent of the total granite reserves across the world. The total granite reserves in India are estimated to be around 13.87 crore tonnes and it is one of the largest exporters of granite and granite products in the world.

1.2 The Southern and Eastern belts of the nation are places where granite is available in abundance such as those in Tamil Nadu, Andhra Pradesh, Karnataka, Maharashtra, Assam, Bihar, Rajasthan, Odisha, Meghalaya and Madhya Pradesh.

1.3 Despite competition from China, Brazil and Saudi Arabia, the Indian granite exports still maintain 4% annual growth rate over the last few years. According to the latest trading data, India exported total of about 1.65 million tonnes in volume, or the equivalent of US$ 839 million in value of granite and granite products to the global market in 2018, representing over 39.3% of the world's total granite exports in that year. The revenue from the granite exports in India is the largest in the stone exports industry. Granite exporters in India export most of its granite to China (55%), the UK (18%) and the US (5%).

1.4 The main colours of granite in India are black, red, blue, grey, green, white and a combination of two or more of these colours. The commercial uses of granite include slabs for flooring (20 mm thickness), tiles for wall cladding (10–15 mm thickness), monuments (such as tombstones) and miscellaneous art effects.

2. PRODUCTION PROCESS

2.1 The first stage in the production process is identification of granite deposits. The deposit may be as a hillock above the ground. It is easier then to know the characteristics of the stone and is also easier to extract the blocks. Pouring water over the raw rock reveals its colour and pattern quite clearly. The deposits may also be found below the surface with small visible

outcrops over ground. In such cases boring has to be done and the stone in powdered form is extracted. An analysis of this powder indicates the type of granite available at different depths.

2.2 If the land is privately owned it may have to be purchased. Quarrying in both private and government owned lands can be done after entering into a lease agreement with the state government and payment of royalty (also referred to as seigniorage or cess fees) to the state government. On identification of the deposit an application has to be filed with the Department of Geology and Mining of the state government with a report on the variety of granite found and its quantity, an Income-tax Clearance Certificate, and a solvency certificate. Once the Village Administrative Officer (VAO) certifies the non-cultivable nature of the land, a joint inspection by the Department of Mines, the VAO and the state Revenue Department takes place to ascertain the declared facts. A government order is then issued to permit quarrying. The lease agreement is signed between the quarry owner and the district collector, who signs the agreement on behalf of the Governor of the state.

2.3 A uniform policy laid down by the central government on granite aimed at unchanging set pattern of leasing and systematic exploitation of granite resources without affecting the environment came into force throughout the country from 01/06/1999. The salient features of these Rules were:

i. Prospecting licenses for a period upto two years.

ii. Leasing of quarry upto 30 years and not less than 20 years in any case.

iii. Minimum area of one hectare and maximum area of 50 hectares.

iv. Renewal of quarry for a period not exceeding 20 years.

Mines & Minerals Development Rules, 2015 were also enacted for regulation of this sector. More specifically rule 8A therein came into effect since 12/01/2015 & the rules regulate lease period, leaseholders' rights, royalty/ levies & local taxes, bidding & auction process etc.

Further, a *National Minerals Policy, 2019* for non-fuel, non-coal minerals has also been announced by the Government of India. The full policy document is available online at www.mines.gov.in. This policy also aims to provide regulations regarding the minerals in India.

2.4 Large blocks, as per the requirement, are separated from the natural formations by drilling along naturally occurring cracks. Such blocks normally have two smooth sides as a result of the drilling. The other sides are manually chiselled into a rectangular shape and made ready for transport. Once these rough cut dimensional blocks, as they are known in the trade, are approved by the buyer and ready for transport, an application is to be filed with the District Mines Office (DMO). The DMO takes the gross measurement and fixes the royalty or seigniorage fees payable. On payment of such fees the transport permit is issued. Such rough cut dimensional blocks may be exported directly as such or given to a granite factory which carries out cutting into thinner slices as slabs or tiles and polishing, usually on one side, before sale. The value addition by cutting and polishing is around 35–40% over the rough cut dimensional blocks.

2.5 In most cases, the quarry owner is himself the exporter of rough cut dimensional blocks. Whatever variety of granite is extracted, the quarry owner has to find the market for it. His business is production-driven. In small quarries where the number of workers is 30 or so payments are made to individual workers through an intermediary called the gang leader. In larger quarries labour contractors referred to

as raising contractors normally supply labour to the quarry owner for separation of the granite blocks from the natural formations and stone cutters for giving shape to the blocks. The loading contractors provide labour for loading the blocks on to the lorries for transport. A heavy crane is used in quarries where the production quantity exceeds 200 cubic meters per month or in quarries where the blocks are to be pulled out from greater depths, while a chain pulley may be sufficient for smaller quarries. All materials and machinery are provided by the quarry owners.

2.6 On the other hand, the business of the granite factories is market-driven. These factories do not normally own quarries, though they may have an understanding with the regular suppliers. They first secure orders and then look for the materials. They purchase the rough cut blocks from the quarries based on these orders for cutting and polishing.

3. COMMERCE IN GRANITE

3.1 Purchase of land, if the deposits happen to be in privately owned lands, is one of the first steps towards initiating business in this industry. Such lands being normally uncultivable waste lands are available fairly cheap. The present rates in Tamilnadu average around Rs. 0.2–1.5 crores per acre depending on the variety and the extent of deposit available.

The seigniorage fees payable varies from state to state and time to time and is Rs.1500 per cubic meter in Tamilnadu presently.

Substantial labour payments (around Rs. 4–7 thousand per cubic meter is paid through the raising contractor to the labourers).

Machinery hire expenses are also considerable. For instance, hire charges for a heavy crane are around Rs. 2 lakh per month.

3.2 The expenses involved in granite extraction are fairly similar irrespective of the variety of granite being dealt with. However, at the cutting and the polishing stages, industrial grade diamond segments are required to be used. There is a substantial cost of such consumable in the processes of cutting and polishing. Accordingly, there is a premium in the market on uniform grained stone which is soft and therefore easier to cut and polish. For instance, rough cut blocks of the black galaxy variety (black with golden spots) from Andhra Pradesh sell in the international market upto US $ 10 per square meter to 80 per square meter (as in the year 2016) depending upon destination port. Red granite of Karnataka sells upto US $ 12 to 25 per square metres while Kashmir White of Tamilnadu sells at about US $ 20 per square meter. At the cheaper end, the pink and red phophery (having small uniform patterns) and the forest green varieties of granite are sold around US $ 10 per square meter.

3.3 Almost 90% of the granite produced in the country is exported. Nearly two-thirds of the export is to Italy whose Carara region specializes in cutting, polishing and re-exporting to all over the world. With sophisticated technology this region is able to convert the entire rough cut block into commercially usable products ranging from slabs, tiles, vases, ash trays and even visiting cards so as to avoid wastage altogether. Another important market for black, grey and red varieties is Japan where the granite is used primarily for monuments such as tombstones. Greece, Spain, China, Taiwan, USA and Canada are the other major buyers of Indian granite. By the quantity exported, almost 90% of the export is of rough cut dimensional blocks, the balance being cut and polished granite blocks.

3.4 Owing to its high cost, there has been a very low demand for granite in the domestic market. However, in the last few years

with increased spending on construction and as an outlet for low grade granite, wastages and rejects from the international buyers, the domestic consumption has been rising.

4. TAX INVESTIGATIONS

There are generally eleven cost components in granite excavation industry. These are drilling, explosives, excavator, trucks, hydraulic jack, cranes, flame jet, transporting of the slab for dressing, salaries for the workers and the management of the quarry, royalty for the quarry site depending on the extent of the area and operation and miscellaneous cost. Of the eleven cost variables to the total cost, drilling and hiring of excavator constitutes about 25 Per cent each, followed by salary for workers and management (17 Per cent), transport of dressed slabs (14 Per cent), and royalty and miscellaneous cost account for 7 Per cent each and hiring of trucks at quarry and crane comprises 1 Per cent each, for excavation of multi colour granite per cubic meter. The same trend is seen in the case of black color granite excavation, by and large, having minor variations in truck-hire at quarry and transport heads.

However, it needs to be kept in mind that above ratios are indicative in nature and depending upon the geography, location etc., these may change to some extent.

4.1 In granite business, as in most other businesses, tax evasion is being practiced by both suppressing the receipts and inflating the expenditure. Export proceeds are less likely to be suppressed because:

i. The product has to pass through the customs barrier;

ii. There is extensive documentation; and

iii. The foreign exchange flow is regulated by the RBI.

4.2 The international market has demand for large blocks. Blocks of smaller dimension find their way to the domestic market. Normally, the quarry owner will take a bulk permit for smaller blocks and also permit for small stones which are used for laying roads. Details of such miscellaneous permits may be gathered from the District Mines Office to ensure that there is no escapement or undervaluation of such sales.

4.3 At the cutting and polishing stage, defects in the block with reference to the uniformity of colour or hairline cracks may be found. These are rejected by the export market. Attempt is usually made to recover products from these defective blocks which are capable of being sold in the domestic market.

4.4 Sales in the domestic market are far more likely to be suppressed. To counter this tendency, effort may be made at quantitative analysis in terms of cubic meters of granite to identify if the entire purchase and opening stock is accounted for by way of sales and stocks available in the factory. The following documents can also be verified and matched:

i. The transport permit issued by the Mines Office.

ii. The customs invoice.

iii. The shipping bills and the bills of lading.

iv. The payment vouchers for block permits.

4.5 Since the price of granite meant for the domestic market is generally lower than the price of blocks exported there is a potential for inflation of the expenditure. This is because the saleable price in the domestic market is much lower than the international rates. However, a granite cutting and polishing factory may continue to show high purchase costs. In such cases, correlation between the entries in the books of both the buyer and the seller concerns may bring out the discrepancies.

4.6 Labour costs are substantial in this industry. The labour is normally provided by contractors. Verification of tax deducted and further investigation with the contractors may provide evidence of inflation of labour expenses.

4.7 Consumables are another major head of expenditure. At the quarrying stage it involves expenditure on kerosene, diesel and drill rods. At the cutting and polishing stage it involves gang saw or circular saw with industrial grade diamond segments. There is scope of inflation of value and quantity of such materials consumed.

4.8 There may also be inflation of purchase price of private land in which granite deposits have been identified. Cross-verification with the seller of the land may help counter this.

4.9 It is seen that very few quarry owners actually operate the mining activity themselves. Though the machineries required for the mining operation will be shown as owned and supplied by the quarry owners but the field evidences show that the sub contractors are generally found at the quarry site while taking out the slabs of different colours and sizes. Also, few quarries, especially, black colour granite have no or inadequate machineries or equipments to excavate granite at the quarry site(s). In other words, these quarry sub-contractors invariably hire from other quarry-owners to excavate granite from the sites. There will be an agreement between the original lessees and the contractors per cubic meter. For all practical purposes or on official records, the lessees names will be figured and the entire mining activity be carried and the royalty will credited to the government against their name. In such cases, the Assessing Officer needs to inquire into the issue of allowance of depreciation, ratio of cost of hire-charges of machinery etc.

5. CONCLUSION

The traditional investigation of verification of capital invested in new project, overstatement of cost of project, understatement of production of mining etc. are common modus operandi of tax evasion in this sector also. The running of mines under a *benami* name is still a common phenomenon. Assessing Officers should refer such cases to the *Benami* Unit of the department.

Now, in place of Sales tax, excise duty etc, the GST (Goods & Services Tax) is applicable. The Assessing Officer may get details of GST paid by the assessee which will provide input regarding quality and quantity of granite products sold by the assessee.

The use of satellite picture/ images/ data may help in investigation in mining sector regarding details of extraction from particular site between the particular periods. Thus, the internet, esp. Google Maps can be of immense help in verifying actual mining activities in a particular area under the control of an assessee. By Google Earth mapping, we can get the mining status and data of particular date of earlier years and we can compare the relevant volume of mining. The Assessing Officers can explore seeking information from ISRO for collecting official data for particular site.

The Controller of Mines and Leases, Nagpur is the authority to grant mining lease. It is a repository of information and an Assessing Officer can seek details of projected excavation and compare the same with actual shown.

The state imposes royalty on all products taken out of the mines. Assessing Officers can collect information from the state mining department to cross-check production shown.

In the mining sector, the profit ratio is high and there is a tendency to shift the profit to associate

concerns. The Assessing Officers may consider the applicability of Arm's Length price provisions in domestic as well as international transactions to determine the real profits of the assessee.

It is a normal practice in the mining industry that sale is suppressed by way of managing lower quality of minerals in the bills raised to avoid GST and Royalty. Normally, the money is paid in advance for purchase of goods and shown as creditors for long time in the books.

It is also a common practice that the bank accounts are opened in the name of the employees and the goods sold outside the books of accounts (or cash portion of suppressed sales in books) and cash received from the customers is deposited directly in these *benami* accounts. The cash is deposited by the customers in these bank accounts throughout India. Suppression of cash sales is a common practice in this trade.

CHAPTER

3

Marble Industry

1. INTRODUCTION

Marble as a building stone has been in vogue in India since times immemorial, lending lustre, beauty and grace to the facades of buildings, monuments, cenotaphs etc. The industry associated with its mining, sawing and finishing has also flourished since then. It is presently spread all over India contributing not only to generation of employment but also to filling the coffers of the nation through a number of taxes, duties and cess. But it is also an accepted fact that a major component of production/ sale is suppressed in this industry resulting in sizeable generation of black money. Due to it being a natural product it does not lend itself easily to verification, hence the ease of understatement of production.

2. GEOLOGY OF MARBLE

The Oxford dictionary describes marble as 'a crystalline limestone capable of taking a polish used in sculpture and architecture.' It is a metamorphic rock formed by recrystallisation of limestone or dolomitic limestone. It is generally medium to fine grained and white in colour, with various shades, strips or spots, and is capable of taking good polish. It is this characteristic which has given it the name of marble which is derived from the Greek root 'marmaros' meaning shining stone. It has the same chemical composition as limestone or dolomite but the chief characteristic of marble is its granularity and formation by recrystallisation due to metamorphosis.

2.1 Many other rocks like yellow limestone (Jaisalmer), black limestone (Chittorgarh), or serpentine rock-green (Udaipur) are also sold in the market as marble hence it is important to know the chemical and physical properties of marble.

2.2 Chemical Composition of Marble: Marble is composed primarily of the mineral calcite ($CaCO_3$) and usually contains other minerals, such as clay minerals, micas, quartz, pyrite, iron oxides, and graphite. Under the conditions of metamorphism, the calcite in the limestone recrystallizes to form a rock that is a mass of interlocking calcite crystals.

2.3 Physical Properties of Marble: Marble occurs in large deposits that can be hundreds of feet thick and geographically extensive. This

allows it to be economically mined on a large scale, with some mines and quarries producing millions of tons per year. Most marble is made into either crushed stone or dimension stone. Crushed stone is used as an aggregate in highways, railroad beds, building foundations, and other types of construction. Dimension stone is produced by sawing marble into pieces of specific dimensions. These are used in monuments, buildings, sculptures, paving and other projects.

3. MARBLE DEPOSITS IN INDIA

The occurrence of marble in India is widely distributed with substantial deposits located in Rajasthan, Gujarat, Haryana and Andhra Pradesh. Recently, substantial mineable deposits of marble have been found in the Jhansi-Jabalpur area of Madhya Pradesh where commercial production has started.

Rajasthan has the richest deposits of marble in the country, both in terms of quality and quantity. It has reserves of around 1000 million tonnes out of total estimated reserves of 1100 million tonnes in the whole of India. The important deposits in Rajasthan are in the Makrana area of Nagaur (white); Babarmal, Rikhabdev and Kelwa areas in Udaipur district (white, pink and green); Rajnagar-Agaria-Amet, Sardargarh and Morwad belt in Rajsamand district (white); Paarwa-Serwa and Salwara in Sirohi district (white); Bhaislana, Andhi-Raialo belt Jaipur district (white, off-white & grey); Bar in Pali district (varied colours & bands); Tripura-sundari in Banswara district (white & off-white); yellow marble deposit of Jaisalmer district; Jhiri-Rajgarh belt of Alwar district (grey, white & pink); Kishangarh deposit of Ajmer district (pink & grey with green patches) and Maonda deposit of Sikar district (greyish-white). Now the latest finds are at Bidasar in Churu district (Multicoloured) and even in Sawai Madhopur district (multicoloured). Makrana area has 5 ridges of marble with widths ranging from 40 to 150 metres which are called Chausera, Dungri, Kumari, Padkua and Borawar. Marble mined from a particular ridge is identified by the name of the ridge.

Table 1: Important Deposits of Marble in Rajasthan

S. No.	Name of Deposit	District
1	Agaria, Amet, Kelwa, Morwad, Kotri, Parvati, Morchana, Vani, Talai, Saprav Ka Guda, Thodi Nijharana, Umti, Jhanjer, Arna, Dharmita, Koyal.	Rajsamand
2	Makrana, Borawad (White), Chausira, Dungri, Paharkuan (pink) Kumari, Ulodi, Pink Range, Kala Nada Talab.	Nagaur
3	Rikhabdeo,Odwas, Darauli, Tidi, Jaspura, Masaron Ki Obri (Green), Paduna, Babarmal, Devimata (Pink), Sarvadi, Manpur, Lohagarh, Kela Kuan (Black), Modi Chipala (White)	Udaipur
4	Tripura Sundari, Bhimkund, Khema-Talai, Bhanwaria-Talai, Kotharia, Vithaldeo, Prithvipura, Paloda, Oda-Bassi.	Banswara
5	Andhi, Bhainslana, Todi-ka-Bas, Kotputli, Raisala, Nimla.	Jaipur
6	Jhiri, Rajgarh, Badampur, Moti-Dungri, Dadhikar, Kho, Baldegarh, Malana, Goverdhanpura.	Alwar
7	Selwara, Ideria, Perwa-Serwa, Khandra, Deri, Morthala, Ajari.	Sirohi
8	Jahajpur, Manohargarh, Asind, Banera, Shahpura, Sarankhera, Kanti,	Bhilwara
9	Munjras, Panchanpura, Malola, Pansel.	Ajmer
10	Narwar, Sardhana, Sursura, Kali-Dungari,Torka, Ladpura, Roopnagar, Kekri, Umaria,	Sikar
11	Sawar, Ganeshnagar.	Dausa
12	Patan, Kela-Dungari (Maonda).	Bundi
13	Dagota.	Dungarpur

Table 1: (Contd.)...

...Table 1: (Contd.)

S. No.	Name of Deposit	District
14	Umar, Pagara.	Chittorgarh
15	Sabla, Nandli-dad, Peeth, Manpur, Dachki, Mal Surata (Green Serpentinic).	Jodhpur
16	Mandal Deh.	Pali
17	Pachori Chadi, Moriya-Munjasar, Au, Indolaiki Dhani.	Churu
18	Bar-Sendra Sarangwa, Kundal, Dujara, Diyana, Khiwandi, Kantatiya, Sewari.	Jaisalmer

Source: Indian Mineral Year Book, 2015: Marble; Indian Bureau of Mines, Ministry of Mines, Government of India

As per the mineral inventory of marble reserves and resources as on 1.4.2010 prepared by Indian Bureau of Mines, total resources of all grades of marble are placed at 1,931 million tonnes. Of these, only about 276 million tonnes (14%) fall under 'reserves' category and about 1655 million tonnes (86%) under 'remaining resources' category. Gradewise, about 27% resources fall under unclassified and not-known grades, 55% under off-colour grade and 17% under white colour grade. The available data on marble resources reveal that about 64% resources are in Rajasthan and 21% in Jammu & Kashmir. The remaining resources are distributed mainly in Gujarat, Chhattisgarh, Maharashtra, Haryana, Uttarakhand and Sikkim in descending order.

4. PRODUCTION

Rajasthan alone accounted for about 88% output value followed by Gujarat (10%) and remaining 2% shared by Madhya Pradesh, Andhra Pradesh and Jammu & Kashmir.

Table 2: State-wise Comparison of Production of Marble in India

(*Value in Rs. '000*)

State	2011–12	2012–13	2013–14
Rajasthan	15172830	17115900	13548846
Gujarat	399729	1945115	1607500
Madhya Pradesh	358015	54565	262388
Andhra Pradesh	81534	13744	37
Jammu & Kashmir	295	537	310
India	16012403	17115900	13548846

Source: Indian Mineral Year Book, 2015: Marble; Indian Bureau of Mines, Ministry of Mines, Government of India

5. MINING AND PROCESSING OF MARBLE

Mining of marble is done by manual, semi-mechanised and mechanised means. In general, majority of mines in India adopt the semi-mechanised method of mining. In manual operation, a line of shallow holes is made and by driving in wedges with feathers by continuous hammering, a fracture is developed along the already drilled holes, and the block is made free from all the sides. The block thus freed from the in situ rock is either pulled by chains or pulley system or is pushed by driving logs, etc. In semi-mechanised operations, drilling machines are used for drilling holes in a predetermined line. The remaining operation is more or less similar to manual mining except for lifting and pulling where cranes, winches, dozers, etc. are used. Nowadays, many mines in India are using modern mining methods involving wire cutting with helicoidal wire, diamond saw wire cutting, cutting with chain saw, and cutting with series of holes and splitting.

After the marble block comes out of the mine it undergoes various processes before it becomes marketable.

5.1 Dressing: Before the marble is put under the sawing machine it is prepared for sawing by evening off its edges usually by the use of a mono blade gang saw. The block becomes, as a result, rectangular or square in shape thus lending itself to easy cutting. This process is called dressing.

5.2 Sawing: This operation is performed normally either by a conventional gang saw using steel blades and sand as an abrasive or a

diamond gang saw using blades with diamond bits. Dressed blocks are put with the help of a crane onto a trolley and then cemented with plaster of Paris and wood wool. The trolley is then positioned under the blade which cuts with the help of abrasive action of sand and water (in a conventional gang saw) and only water to keep the blade cool (in a diamond gang saw).

5.3 Grinding and Polishing: A sawn slab is given a smooth finish by rubbing, gritting, buffing and polishing which is done with the help of various machines and abrasives available for the purpose. Polishing is done in 3 to 4 stages and the size of the grinding medium is reduced in every successive stage, *viz.* 40, 80, 120 and even nowadays 1200 mesh size is used for polishing. Polishing bricks are used on polishing machines; Polishing can be done manually also but it is very time-consuming.

Almost 95% of processing in India is done in Rajasthan. Important processing centres in the State are Makrana, Jaipur, Alwar, Ajmer, Udaipur, Nathdwara, Rajsamand, Abu Road Banswara, Chittorgarh and Kishangarh. The capacity for marble slab production in the state is around 1,000 million sq ft per annum and for polished tiles, it is 3,000 million sq ft.

6. GOVERNMENT POLICY ON MARBLE

The Central Government has notified Marble Development and Conservation Rules, 2002 (notified on 15/05/2002) for conservation, systematic development and scientific mining of marble with a purpose to provide a uniform framework that would be applicable throughout the country. The maximum period for which a lease may be granted shall not exceed thirty years and minimum period shall not be less than twenty years. Further, no lease is to be granted unless there is mining plan duly approved by the State Government or any person authorised in this behalf by that Government. Normally, the minimum area of the lease to be granted should not be less than 4 hectares and maximum area shall not exceed 50 hectares.

Indian standards for marbles (blocks, slabs and tiles) IS:1130–1969 (reaffirmed in 2008) are summarised as under:

i. **Classification:** Marble shall be classified as white and coloured categories.

ii. **General Requirements:** Marble shall be free from foreign inclusions and prominent cracks.

iii. **Sizes:** Marble blocks shall be supplied in lengths ranging from 30 to 250 cm, widths 30 to 100 cm and thicknesses 30 to 100 cm. The slabs shall be supplied in lengths ranging from 70 to 250 cm, widths 30 to 100 cm and thicknesses from 20 to 150 mm. The tiles shall be supplied preferably in sizes of 10×10cm, 20×20cm, 30×30cm, 40×40cm, 50×50cm and 60×60cm with thickness ranging from 18 to 24 mm in the same piece.

Other sizes as agreed upon by supplier and purchaser may also be supplied.

iv. **Physical Properties:** The physical properties of blocks, slabs and tiles shall conform to the requirements as given under:

Table 3

S.No.	Characteristic	Requirement	Method of Test
1	Moisture absorption after 24 hours immersion in cold water	0.4%	IS: 1124–1974
2	Hardness	3 min	Mohs' Scale
3	Specific Gravity	2.5 min	IS: 1122–1974

v. **Workmanship:** The edge of slabs and tiles shall be true. The finishes shall be sand and/ or abrasive-finish, honed-finish or polished-finish.

7. EXPORT AND IMPORT OF MARBLE

Out of total marble exported in 2014–15, exports of dressed marble was 2,09,954 tonnes (64%), and exports of other marbles was 115,751 tonnes (36%). Exports were mainly to China and Nepal (19%) each, Egypt (16%) and USA (7%). Imports of dressed marble at 641,493 tonnes accounted 82% of the total imports in 2014–15 while the remaining 18% imports were of other marbles. Main suppliers of marble were Italy (42%), followed by Turkey (25%), China, Oman (7%) each and Vietnam (6%)

8. MARBLE TERMINOLOGY

Certain terms are frequently used in the trade which need to be known and understood.

i. **Block:** The rough stone as taken out of the mine. It is converted into slabs, tiles etc.

ii. **Luffer:** This is an irregular marble block which cannot be converted into slabs since it cannot be given a perfect rectangular shape capable of being sawn into slabs due to either its shape or defects therein like cracks, spots, etc. The recovery of mineral in a luffer is much less than in a block. It is sold as such to be normally converted into tiles and small slabs but the wastage in such an operation is well above average.

iii. **Khanda:** This is a block with no commercial use. It is treated to be part of the overburden. Khandas have no commercial value and are like overburden which has to be disposed off or stacked in heaps as waste. However some units in Alwar region and near Nathdwara are producing chips out of them to be used as flooring material.

iv. **Kareji:** These are end pieces or cracked pieces of a block. Being small irregular pieces of marble, they are generally used in flooring.

v. **Churi:** This is powdered marble which is usually treated as waste. It is used as plaster on walls or in making artefacts like statues.

vi. **Tile:** This is a small piece of marble, much longer than broad resembling a brick. Tiles can be made out of luffers and slabs through the use of wheel cutter machines.

vii. **Slab:** Slabs are obtained when blocks are sawn. They are used in flooring and also in walls, roofs and other types of construction. They can be converted into artefacts also. It commands maximum price depending on its size, colour, texture etc.

viii. **Albetam:** This is better type of marble found in Makrana.

ix. **Adanga:** This is Makrana marble of average quality.

x. **Pista:** This is marble with green veins and green spots found primarily at Andhi.

xi. **Indo-Italian:** This is softer variety of marble found primarily at Andhi with veins and lines making different forms and figurines.

9. TAX INVESTIGATIONS

9.1 Verification of Capital: When a new project is started the capital could be raised either through borrowings from financial institutions, promoters or in case of a public issue, from the general public in the form of share capital. The total cost of a gangsaw unit with allied facilities being over a crore of rupees substantial amount may come from the promoters and public. The investment of a public limited company made in the promoter's quota and the public quota needs closer scrutiny. It is at this stage the promoter tends to bring in his undisclosed income. Thus, though no income may be shown, the first-year returns need to be closely examined to verify the genuineness of the capital being introduced in the first year.

9.2 Overstatement of Cost of Project: Quite a number of times, assessees attempt to inflate the cost of the project for getting higher subsidy and boosting the claim of depreciation. They may also get a percentage on the difference between the actual cost and inflated cost from the seller which is usually deposited

in a bank account abroad. This inflation cannot be normally proved unless the Assessing Officer makes serious attempts to first ascertain the 'make and model' of the machinery purchased and then its cost in the open market. This is also not sufficient. He may have to ascertain whether the assessee has derived some tax benefit out of inflating the cost of machinery. If he forms an opinion that the cost of the machinery is obviously inflated he can either make verification from the records of the seller (if seller is situated in India) or refer the matter to the FTD Division of the CBDT (if the seller is a foreign concern) to find out whether purchaser received any commission.

9.3 Understatement of Production from Mines: The first point at which tax can be evaded in the form of understatement of production can be at the time of mining. Even before mining takes place a mine has to be 'developed'. It means that the place has to be cleaned of all plant growth. Overburden in the form of earth above the mineral vein (deposit) has to be cleaned out and stacked at a reasonable distance from the mouth of the mine. Then a winding path has to be made which allows the mining machinery and dumper etc. to reach the mouth of the mine. This operation itself entails substantial expenditure which may be invested by the mine owner out of books especially if the mine is in a benami name.

The Controller of Mines and Leases, Nagpur is the authority to grant mining lease. It is a repository of information and assessing officer can seek details of projected excavation and compare the same with actually shown quantity

9.4 Business in Benami Names: During the course of a search conducted on some well-known stone dealers, it was discovered that the assessee had taken a mine in a benami name and had invested lakhs of rupees in developing it and profits derived therefrom were not disclosed to the Department. In another search case the assessee claimed during assessment proceedings that he had spent Rs. 3–5 lakhs per mine in its development out of his undisclosed income. Of course, the Assessing Officer disallowed the claim but the ITAT ruled that the undisclosed income of the assessee ought to have been calculated on the asset/ expenditure theory.

9.5 Overstating of Development Expenses: However, if the mine is in the assessee's own name then he tends to overstate the development expenses. They are incurred before the start of the mining operation and hence could be capitalised. The assessee can claim higher depreciation. The Assessing Officer would do well to scrutinise the development expenses shown for detecting inflation of the expenses, if any.

9.6 Verification of Block Excavation: Once the mine is developed, the assessee starts the process of taking out marble blocks by any of the methods already elaborated. He pays royalty to the state Mining Department on 'per tonne of block excavated' and taken out of the mine. The royalty is calculated on the basis of weight from a weighbridge (dharamkanta) shown on the 'ravanna' receipt issued by the Mining Department. This weighbridge is normally located very near the checkpost of the Department. Marble mines are usually in remote areas which cannot be accessed by all-weather roads. There are also multiple points of entry and exit. It is not possible for the Department to keep a checkpost for each and every mine or to have a weighbridge at the exit of such mines. To overcome this practical difficulty the mining department in Rajasthan now issues a ravanna showing prefixed weight of 15 M.T. per truck of blocks taken out of the mine on the assumption that a truck must be carrying, on an average, 15 M.T. of marble blocks per trip. If the actual weight in a truck is less, the mine owner is at liberty to have the truck weighed on the nearest weighbridge and formally lodge a claim for

refund of royalty with the mining department on the basis of the weighbridge receipt.

9.7 Verification of Sales Bills: In the case of a mine owner who was selling marble blocks as such (without cutting them into slabs), a search was conducted under Section 132. It was found that, while he was paying royalty as per the weighment standards fixed, he was showing less weight in his sale bills. Some of the sale bills reflected the sale price per M.T. while others showed either rate per truck or rate per cubic feet (c. ft.). The Assessing Officer converted the truckload c.ft. into M.T. and found that the M.T. weight of blocks so computed was much less than the weight as per ravanna receipts. He added the difference as unrecorded sales.

In appeal it was argued by the assessee that the ravanna showed a prefixed weight which was not the actual weight of the blocks. The actual weight was recorded on the sale bills. Moreover, the price of the block was dependent on its quality and size and not the weight. The plea did not find favour with the CIT (Appeals). He confirmed the addition on the ground that the AO's finding was based on specific material and rational calculation and was not simply an estimated addition.

However, the assessee's argument could have been met solidly by a simple logic that some of the sale bills themselves showed rate calculated per M.T. and so the rate did not depend directly on the weight. The assessee pays royalty on the prefixed rate shown on the ravanna. If the actual weight of the marble blocks was less than 15 M.T. per truck, then the assessee would have moved the mining department for a refund. No evidence of such an application was brought on record which meant that the assessee was accepting the weight shown on the ravanna as correct. Further, the purchaser pays freight to the seller on per M.T. basis and therefore he should have collected weighbridge slip from the seller to know the actual weight. A seller is expected to have the truckload of blocks weighed on a dharamkanta and that evidence is available with assessee. If he is not producing it intentionally, adverse inference could be drawn.

9.8 Verification of Sales: It is relevant to mention that the records on the basis of which the Assessing Officer makes the addition are records which can be requisitioned even otherwise during the assessment proceedings and a verification done whether the weight shown in the sale bills matches with the prefixed weight on the ravanna receipt or not. There is another way of verification of sales. Each ravanna receipt carries the name of the mine, mineral as also the mine owner besides quality of the mineral, name of the purchaser and address, the registration number of the truck and the quantity of the mineral and time of its dispatch. Record is also kept at the mining department check posts. This record can be tapped for information about the sales made by an assessee.

9.8.1 In Rajasthan, the Sales Tax Department maintains an outpost near Makrana (marble town of India) where Sales Tax is charged on all outgoing material. Sales tax at the rate of 3% is charged on blocks against 'D' form while, in the case of slabs, 12% + surcharge is charged from consumers for sales within the State while 12% is charged on Interstate consumers. In the cases of dealers, Sales Tax is charged at 4% against Form 'C'. Details of all the trucks that pass through as well as the quantity of material and the identity of purchaser and seller can be verified from the record of the sales tax checkpoint at Makrana, or for that matter, any other mining area.

9.8.2 Further, Rajasthan Sales Tax Department has fixed the minimum selling rate of every type of marble and Sales Tax is charged as per this schedule of rate irrespective of the rate mentioned in the sale bill. This fact can also be utilised for cross-verification as in case the rate on the sale bill is less than the minimum rate fixed by the department, this possibly could be the starting point of investigation into the results shown by the assessee.

9.9 Understatement of Production of Slabs: Understatement of production can be achieved by not showing the true square footage of slabs manufactured out of the blocks and by either not showing at all the quantity of side-products or alternatively, the correct quantity. It is important to point out here that a gangsaw owner who cuts slabs out of blocks is deemed to be a manufacturer by the Central Excise Authorities as a consequence of which he has to maintain, inter alia, a daily stock account of finished goods which is called the RG-I register and has also to file a monthly return of sale of finished goods in the RT-12 form. He has also to issue gate passes every time goods leave the factory. If the gangsaw owner is cutting blocks for himself (i.e. he is the owner of the blocks) then he has to pay excise duty on the slabs dispatched and show it as part of the cost of production. However, if the gangsaw owner is doing only job work for others, then also he has to pay excise duty on the slabs coming out of his factory. He recovers the duty from the owner of the block/ slab.

9.10 Verification of Records of Daily Receipts & Dispatch: During the scrutiny of a case of an assessee doing job works, the Assessing Officer noticed that the assessee did not maintain any record of receipt of material or of dispatch after completion of the job work. Therefore, he rejected the books of account and applied the gross profit rate. However, the addition so made was deleted by the CIT (Appeals). The ITAT also upheld the order of the CIT (Appeals) on the ground that the assessee was maintaining RG-I register, gate passes and RT-12 forms in which the daily production and dispatch were duly recorded. Since the assessee was maintaining proper Excise records showing daily production and dispatch and no defect was pointed out by the Assessing Officer, the appellate authorities felt that the assessee's results were backed by proper records. Unfortunately, the Assessing Officer had failed to meet this argument in the body of the order. It was not clarified by him that RG-I was only a daily stock account of the finished goods, namely slabs, and it was not at all indicative of the material received for cutting which would normally be reflected in the Inward receipt register. The records of the assessee were clearly deficient in this crucial respect. There were no details regarding the number and the size of the blocks received for cutting. The results reflected in the RG-I register were not subject to verification at all contrary to what the CIT (Appeals) and the ITAT were led to believe. These registers were also not periodically checked by the Excise authorities. Now, it has been specifically provided that the registers can be checked by an Inspector of Central Excise only if there is a complaint. The figures in the RT-12 form are but some sort of a self-assessment of the Excise liability. These facts should have been elaborately mentioned in the assessment order to strengthen the departmental case. The Assessing Officer perhaps through oversight accepted the income shown by the assessee from dressing operations. For such operations no statutory records are kept. If the assessee was not maintaining any Inward receipt register, then the income from dressing would altogether go beyond verification.

9.11 Verification of Consumption of Electricity, Diesel Etc: Another way of verifying production is to check the consumption of electricity, diesel, diamond bits/ segments attached to the gangsaw, wood wool and plaster of Paris. It is seen that AOs tend to make additions of suppressed production by dealing with normally one of the above parameters. Consumption of electricity is the most common. There are enough judicial pronouncements to the effect that the results of the assessee cannot be disturbed on the basis of only one parameter which can differ for a variety of reasons. For example, consumption of electricity could be more if the block's surface is abnormally hard. The actual consumption can also be higher in a month in which the bill is received. Since each one of the parameters provide, at best, only

circumstantial evidence, all parameters have to be correlated and examined together. This will make department's case of suppression of production strong. It may be pointed out here that some gangsaw machines are fitted with a Feed meter which shows the speed of cutting. Assessee can be asked to give original readings for comparison and consideration.

9.12 Ascertaining Production Figures: There are other indicators also which may help in ascertaining the exact production figures. Blocks are measured in cubic feet while slabs are measured in square feet. Unless cubic feet are converted into square feet it is difficult to judge whether the production shown is correct. Normally this conversion cannot be done unless the thickness of the slab is known because the length and width are common parameters in both cubic feet and square feet. It is therefore pertinent to point out that a slab is usually 16–17 mm thick going up to a maximum thickness of 20 mm. With this information the cubic feet can be converted into square feet for verification of the production.

9.13 Verification of Production Through Capacity of Dispatch Vehicles/ Trucks: Another indicator to verify production is the quantity being dispatched in a truck. Normally 190–200 sq. ft. of tiles and 170–180 sq. ft. of slabs weigh one M.T. The quantity in M.T. dispatched can be verified and totalled from the ravanna receipt and/ or the weighbridge slip. The quantity dispatched can then be verified and correlated with the quantity of production (both to be measured in either sq. ft. or M.T.). In one of the important search cases, seized documents indicated gross under billing of the sales quantity besides number of other discrepancies. Additions on this score were made. The ITAT while hearing the case observed that the income computed by the Assessing Officer could not be accepted as validly made. There was an unexplainable difference between the income computed and the assets found/ expenditure made as per the seized documents/ records. The ITAT in principle agreed that it was a case of concealment. It computed the undisclosed income on the basis of asset/ investment/ expenditure theory according to which the income earned by an assessee should be either reflected in an asset found during the search, be it movable or immovable, or in expenditure. This it did in the view that, in a search, the entire expenditure and all the assets are fully exposed to the department. Even then, it had to confirm an addition of nearly Rs. 1.5 crore.

9.14 Understatement of Sale Price: Understatement of sale price of blocks and slabs, especially slabs, is the commonest form of tax evasion which should be looked into.

9.14.1 Under-Invoicing in this Trade: The extent of the under-billing/ invoicing in this trade can be gauged by the fact that, in a search operation on a marble dealer, under billing to the extent of 60% was admitted by the dealer himself in the statement recorded under Section 132(4) leading to confession of extra income to the tune of approximately Rs. 1.50 crores. The case of the Department was proved by the incriminating documents seized during the course of the search. However, there is no standard method by which production of blocks in a mine or of slabs in a factory can be scientifically and accurately computed. The facts detailed above can act as indicators in a serious investigation case.

9.15 Verification through GST Paid: There are different GST rates on various marble products i.e. raw marble, marble blocks, marble slabs, marble statues, etc. During investigation of a marble firm engaged in mining/ processing, the Assessing Officer should get details of GST paid by the assessee which will provide input regarding quality and quantity of marble products sold by the assessee. Also the E-way bills generated in the case of the assessee can be examined to comprehend the total turnover.

9.16 Verification using Satellite Data: The use of satellite picture/ images/ data may help in investigation in mining sector regarding details of extraction from particular site between

the particular periods. Thus, the internet, esp. Google Maps can be of immense help in verifying actual mining activities in a particular area under the control of an assessee. By Google Earth mapping, we can get the mining status and data of particular date of earlier years and we can compare the relevant volume of mining. The Assessing Officers can explore seeking information from ISRO for collecting official data for particular site.

9.17 Sales Suppression by Lowering Quantity in Sale Bills: It is a normal practice in the marble industry that the sale is suppressed by way of managing lower quality of marbles in the bills raised to avoid GST and Royalty. Normally the money is paid in advance for purchase of goods and shown as creditors for long time in the books.

9.18 Cash Deposits in Benami Accounts: It is also a common practice that the bank accounts are opened in the name of the employees and the goods sold outside the books of accounts (or cash portion of suppressed sales in books) and cash received from the customers is deposited directly in these **benami** accounts. The cash is deposited by the customers in these bank accounts throughout India.

9.19 Verification through Royalty Paid to States: The state imposes royalty on all products taken out of the mines. Assessing Officer can collect information from the state mining department to cross check production shown.

9.20 In the mining sector, the profit ratio is high and there is a tendency to shift the profit to associate concerns. The Assessing Officers should consider the applicability of Arm's Length price provisions in domestic as well as international transactions to determine the real profit of the assessee.

10. CONCLUSION

As mentioned above, the common modus operandi of tax evasion in marble industry is through production suppression, invoice manipulation & under-reporting of sales. The cash generated through unaccounted sales is deposited in benami bank accounts and same may be routed to assessee's business either through unsecured loans or share application money or as investment in properties directly in the name of benamidars.

CHAPTER

4

Cement and Cement Products

1. INTRODUCTION

1.1 India is the second largest producer of cement in world after China. Cement plays an important role in development of the country and contributes very high in Indian GDP. A significant factor which aids the growth of this sector is the ready availability of the raw materials for making cement, such as limestone and coal. The industry occupies an important place in the national economy because of its strong linkages to other sectors such as housing, transportation, power and construction.

1.2 There is a wide range of cement varieties like Ordinary Portland Cement (OPC) which is used for ordinary concrete work, mortar, plaster etc, Blended Cement which is used in marine structures and Special cements (white cement, sulphate resistant cement, rapid hardening cement, oil well cement). Blended cements like Portland Pozzolana Cement (PPC) & Portland Blast Furnace Slag Cement (PBFSC) have about 75 Per cent of the market share today whereas OPC accounts for 25 percent. Portland cement is used for mass construction work and low cost housing projects.

Cement can be produced through two basic processes-wet process and dry process. Dry process, being cost efficient, is widely used and accounts for about 97 Per cent of production capacity in India.

2. CEMENT MANUFACTURING PROCESS PHASES

Production of cement completes after passing of raw materials from the following six phases. These are:

2.1 Raw Material Extraction/ Quarry: Cement uses raw materials that contain calcium, silicon, iron and aluminium. Such raw materials are limestone, clay and sand. Limestone is for calcium. It is combined with much smaller proportions of sand and clay. Sand & clay fulfill the need of silicon, iron and aluminum. There are also various other raw materials used for cement manufacturing. For example shale, fly ash, mill scale and bauxite. These raw materials are directly brought from other sources because of small requirements. In India the prominent cement companies either own their limestone quarries or take some quarries on long term lease. Some cement factories use calcareous

material in place of limestone. Some factories which do not have their own quarries purchase limestone from others.

2.2 Grinding, Proportioning and Blending: The raw materials from quarry are routed in plant laboratory, where they are analyzed and proper proportioning of limestone and clay is made possible before the beginning of grinding. Generally, limestone is 80% and remaining 20% is the clay.

2.3 Pre-heater Phase: After final grinding, the material is ready to face the pre-heating chamber. Pre-heater chamber consists of series of vertical cyclone from where the raw material passes before facing the kiln.

2.4 Kiln Phase: The processes are briefly discussed below:

i. **Wet Process:** In this process the raw material are ground together with water to form a slurry and the slurry is fed into the kiln. Raw material used are chalk and clay.

ii. **Dry Process**: In the dry process raw material are dried, ground to the necessary fineness and homogenised before being fed into the kiln as a mixture of dry powders.

iii. **Semidry Process**: This process is preferred when limestones are found to be having high alkali content as the alkalies tend to deposit on the pre-heaters which are used in the dry-process. In this particular process, water is added to the raw meal to nodulize the meal. The nodules are then reheated on an enclosed moving grate by the exhaust gases from the kiln.

Kiln is a huge rotating furnace also called as the heart of cement making process. Here, raw material is heated up to 1450°C. This temperature begins a chemical reaction called decarbonation. In this reaction, material (like limestone) releases the carbon dioxide. High temperature of kiln makes slurry of the material. The series of chemical reactions between calcium and silicon dioxide compounds form the primary constituents of cement i.e., calcium silicate. Kiln is heating up from the exit side by the use of natural gas and coal. When material reaches the lower part of the kiln, it forms the shape of clinker.

2.5 Cooling and Final Grinding: After passing out from the kiln, clinkers are cooled by means of forced air. Final process of 5th phase is the final grinding. Heresteel balls tumble and crush the clinker into a very fine powder. This fine powder is considered as cement. During grinding, gypsum is also added to the mix in small percentage that controls the setting of cement.

2.6 Packing & Shipping: Material is directly conveyed to the silos (silos are the large storage tanks of cement) from the grinding mills. Further, it is packed into bags of about 20–40kg.The cement in bags is then dispatched by railway wagons which come into the packing bay by means of special siding or by trucks. The end product is also tested to see that it conforms to the established specifications.

3. LIST OF MAJOR CEMENT PRODUCING STATES IN INDIA

Table 1

Cement Producing States	Plants
Madhya Pradesh	Satna, Katni, Maihar, Jabalpur, Ratlam, Neemach, Banmor, Akaltara
Chhattisgarh	Jamul, Durg, Mandhar
Andhra Pradesh	Vijayawada, Krishna, Guntur, Kurnool, Adilabad, Vishakhapatnam
Rajasthan	Sawai Madhopur, Udaipur, Lakheri, Churu, Chittorgarh
Gujarat	Porbandar, Jamanagar, Dwarika

Table 1: (Contd.)...

...Table 1: (Contd.)

Cement Producing States	Plants
Tamil Nadu	Tulukapatti, Thalaiyuthu, Dalmiapuram, Tirunelveli
Karnataka	Bhadrvati, Shahabad, Kurkunta, Bagalkot, Gulbarga
Maharashtra	Chanda, Ratnagiri, Sevari, Manikgarh
Bihar	All cement plants in Bihar have been set up on the bank of the river Son. Banjari, Dalmianagar, Kalyanpur are major cement plants.
Jharkhand	Sindri, Khelari, Jhinkpani (Chaibasa), Japla (Palamau)
Uttar Pradesh	Churk, Dalla, Chunar
Haryana	Surajpur, Charkhi Dadri
Odisha	Rajgangpur, Hirakund
Himachal Pradesh	Rajban, Gagal
Jammu & Kashmir	Wuyan, Basoli, Khrew
Assam	Bokajan
West Bengal	Durgapur
Uttarakhand	Dehradun

4. KEY CHARACTERISTICS OF THE INDIAN CEMENT INDUSTRY

i. The industry is highly capital and energy intensive. A one million tonne capacity plant along with diesel power generating set requires an investment of approximately Rs. 450–500 crore. Approximately 750–1000 Kcal of energy is required per kg of clinker produced.

ii. Cement, being a bulky commodity, is unviable to transport across the country due to high logistic costs. Freight cost accounts for about 20–25 per cent of operating cost.

iii. Top cement industries in five geographical regions of India are as under:

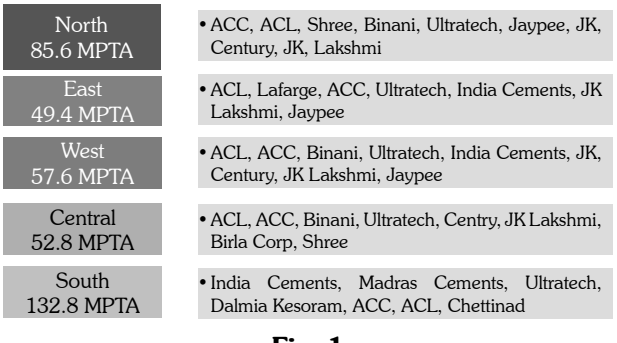

North
85.6 MPTA
• ACC, ACL, Shree, Binani, Ultratech, Jaypee, JK, Century, JK, Lakshmi
East
49.4 MPTA
• ACL, Lafarge, ACC, Ultratech, India Cements, JK Lakshmi, Jaypee
West
57.6 MPTA
• ACL, ACC, Binani, Ultratech, India Cements, JK, Century, JK Lakshmi, Jaypee
Central
52.8 MPTA
• ACL, ACC, Binani, Ultratech, Centry, JK Lakshmi, Birla Corp, Shree
South
132.8 MPTA
• India Cements, Madras Cements, Ultratech, Dalmia Kesoram, ACC, ACL, Chettinad

Fig. 1

iv. Cement industry is dominated by top 10 companies namely; ACC Limited, Ambuja Cement, Ultra Tech, Grasim, J.K. Cement, Century Cement, Jaypee Cement, Ramco Cement and Birla Cement. They account for around 65 Per cent of the market which proves that the industry is dominated by few players. (Source IBEF).

5. TAX INVESTIGATIONS

5.1 Manufacturing and Trading Account: While investigating this, the Assessing Officer should consider the quantity of cement produced *vis-a-vis* the raw material utilised in the process of manufacture. One should start with the scrutiny of raw material consumed by the cement factory. The principal raw material for producing portland cement are limestone and gypsum.

5.1.1 Limestone is the basic raw material and its consumption may be as high as 1.5 tonnes per tonne of cement. However, some factories have started using sand and coral (akin to limestone) obtained from seabed for

increasing the production of cement. Norms of consumption for a particular cement factory have to be determined by analysing the consumption of different raw material in past 5 to 6 years and the patterns emerging from the study of the accounts of other similarly placed factories and plants.

5.1.2 Among the supplementary material used for production of ordinary Portland cement, gypsum is a major item. Ordinary Portland cement is produced by grinding clinker with 3–6% gypsum, which acts as a retarder against a too rapid setting of cement. The Assessing Officer should examine the percentage of gypsum used in the production of ordinary portland cement.

5.1.3 Wherever slag and pozzolanic materials like fly ash are used, the proportion of their consumption needs to be fully appraised. Due to variations in the quality of clinker and slag, a standard norm of slag consumption cannot be laid down.

5.1.4 In order to ascertain whether the production of cement has been correctly reflected and no excessive consumption of main or supplementary raw material is being claimed, the Assessing Officer may enquire into the consumption of raw material and the quantum and percentage of cement production in the relevant previous year and immediately preceding three years. The percentage of consumption at each stage of consumption should be compared. The stages at which comparison ought to be made include slurry production and clinker production. The Assessing Officer has to carefully analyse the data in respect of:

a. Total consumption of limestone and other raw material.

b. Quantity of slurry produced and percentage of slurry to the consumption of slurry.

c. Quantity of clinker produced and percentage of clinker to the consumption of slurry.

d. Consumption of clinker and other raw supplementary raw materials like gypsum and slag.

On the basis of data analysed in the aforesaid stages, the Assessing Officer should work out the percentage of cement produced to the total raw material consumed. If there is substantial variation in the percentage of raw material vis-a-vis cement manufactured, the case needs to be further probed.

5.1.5 Power and Fuel

The utilities consumed in the manufacture of cement are broadly classified into three groups:

a. Power.

b. Fuel.

c. Stores and spares.

Next to coal, power is the most important cost component. In a study, the National Council of Applied Economic Research worked out that the weighted average in the industry was 127 Kwh per tonne. The overall power consumption per tonne of cement produced varies even within the groups employing wet, dry and semidry processes. Wet process requires on an average 100 Kwh per tonne of cement while 130 Kwh are required in the manufacture of one tonne of cement by dry process.

a. The variations in the consumption of power could be attributed to efficiency in the operation of the raw mill, kiln and cement mill, size of plant (300 tonnes per day, 600 tonnes per day or 1200 tonnes per day), the quality and type of limestone used, the quality of the power supply (shedding, tripping, stoppages and their extent and frequency) and the type of cement produced. Wherever the power consumption is found to be high, the possible reasons for it should be looked into. Reasons for abnormal high power consumption are low capacity of operation and power interruptions, high frequency of

load-shedding and power trippings. In case of units having captive power facilities, it should be ascertained whether the assistance received from the government has been properly accounted for or not. However, the cost of power should not be considered in isolation and the expenditure on coal must also be kept in view while making comparisons. On the basis of the aforesaid guidelines, reasonableness of the consumption of coal disclosed by the assessee could be determined.

b. **Consumption of Stores and Spares:** The stores should have been valued on the same basis and the records must clearly indicate the method adopted. It is expedient for an Assessing Officer to ascertain whether the details required in terms of Cost Accounting Records (cement) Rules have been kept by the assessee in relation to stores and spare parts also. He must check and ensure that workable stores and spare parts are not passed on as unserviceable or damaged and losses in these amounts are properly quantified.

c. **Other Manufacturing Expenses:** The Institute of Applied Manpower Research in their study 'Manpower in the Cement Industry' have observed that an average 24.9% of the workers are employed in a quarry. The Institute has estimated that in the factory 58.2% of the workers are unskilled. Cost Accounting Records (Cement) Rules require that proper and systematic records should be maintained for the attendance of workers and other operating staff. Wherever payments to workers are made on a piece rate basis, the records kept thereof should be so maintained as to enable assessment of wages payable to such workers. Correct data also need to be maintained in respect of all payments made for overtime work. The records relating to salaries and wages should be examined in detail to find out whether there was any inflation in wages or not. Wherever, manipulation is suspected, the Assessing Officer must get thorough enquiries conducted through ward inspectors.

d. **Packing:** The cement produced can be packed in old or new gunny bags or paper bags. The percentage of old and new gunny bags is normally fixed by the government and may vary from time to time. While use of old gunny bags means some saving to the manufacturer, it causes more spillage and consequent loss to the consumer.

e. **Transport:** Transport of limestone, gypsum and other raw material is another prominent expenditure. The cost of transport of limestone from the quarries to the factory site constitutes a major chunk of the cost of production. An important point to be checked in this context is the distance from the limestone quarries to the factory site, since it has a bearing on the cost-element quantum subsidy which some factories receive under the freight pool system. The Assessing Officer should check the distance from mines, salt works, or fertilizer units to the factory receiving gypsum, as it may have significant bearing on the overall cost of gypsum. Similar checks regarding the distance of supply points need to be exercised in case of other raw material.

5.2 Profit and Loss Account

5.2.1 Certain expenses often figure in the accounts of the cement companies. One such item is the commission paid to sole selling agents and other selling agents appointed for the sale of cement and cement products. The selling and distribution expenses include such commission. The Assessing Officer should call for the following information, in order to judge the allowability of the commission.

Agreements entered into by the assessee with its sole selling agents; Actual services that have

been rendered by the sole selling agents, in terms of various Clauses of agreements, towards the sale, etc. of the cement or cement products.

On an examination of these, the Assessing Officer can decide whether the services rendered are commensurate with the commission paid.

5.2.2 Allowability of the *interest* debited to the accounts is an important matter. Often, the assessee takes interest-bearing loans from banks, financial institutions, etc. and advances either the whole or a part of it interest-free to a subsidiary or a sole selling agent. Proportionate interest disallowance on account of such diversions should be made in the assessment. The appellate authorities have held in a number of cases that for effecting the disallowance, proof of nexus between the interest-bearing borrowing and the interest-free diversion is necessary. The Assessing Officer should gather material facts that would prove such nexus and fortify his order.

5.2.3 Big cement companies also spend substantial amount on advertising. These expenses could also be enquired into.

5.2.4 Most of the expenses debited to the P&L account are not industry-specific. The Assessing Officer may fruitfully refer to Chapter 9 of Volume-I of the Techniques of Investigation Manual for informing himself about the enquiries that should be made with respect to such items.

5.3 Apart from domestic mergers, cement industry in the country has also seen various foreign players like Lafarge, Holcim, Heidelberg and others entering the Indian market opting for the brownfield route by buying stake in established domestic cement companies. It will be fruitful for Assessing Officers to enquire into such transactions and verify the valuation of shares, capital gains etc related to such transactions.

5.4 Cement manufacturers also establish captive power plants within their cement factories and claim related exemptions and deductions as provided in the Income-tax Act. For assessees claiming such deductions, Assessing Officers should definitely look into the apportionment of expenses between eligible and non eligible units.

5.5 Apart from this the Assessing Officers should also closely examine the capital expenses made by the cement manufacturers on year to year basis because these expenses are usually used to siphon off cash by booking bogus capital expenses.

5.6 Sales disclosed by the cement companies should also be checked critically.

CHAPTER 5

Ceramics and Pottery

1. INTRODUCTION: CERAMICS

1.1 The product range in the ceramic industry includes Digital Tiles, Vitrified Tiles, Wall Tiles, Floor Tiles, Porcelain Tiles, Sanitaryware, Quartz Stone, Roofing Tiles, Mosaic Tiles, Crockery, Glassware etc.

1.2 The Indian Ceramic Industry is divided into two sectors i.e. "Organized and Unorganized sectors". The Organized Sector comprises of approximately 14 players. The Unorganized Sector accounts for nearly 60% of the total industry bearing testimony of the growth potential of this sector.

1.3 India ranks in the top 3 countries in terms of Ceramic tile production in the world. However, with proper planning and better quality control our exports contribution can increase significantly.

1.4 Ceramic tiles as a product segment have grown to a sizeable chunk today. However, the potential seems to be great, particularly as the housing sector has been witnessing an unprecedented boom in recent times.

1.5 Morbi District is the most promising ceramic tiles manufacturing hub of India. It is located in Saurashtra region of Gujarat. The city is home to more than 600 ceramic products manufacturing units. Morbi is heart of ceramic industries in India manufacturing more than 70% of total ceramic production in India. The ceramic units of Morbi also caters to export market in other countries like Middle East, African Countries, Sri Lanka, and Bangladesh, etc. In recent years Morbi has also become an important manufacturing outsourcing zone. Many leading ceramic companies like HR Johnson, NITCO, Kajaria Ceramics, Orient, Regency, Asian Tiles and Somani Tiles are outsourcing their requirements from Morbi and Himmatnagar.

The region around Morbi (i.e. Wankaner, Dhuva, and Thangadh) is a virtually untapped ceramic zone. It is India's most promising ceramics production hub with scores of innovative and enthusiastic tile and sanitary ware manufacturers. The pace of production capacity growth in this region has been explosive and this trend is set to continue for the foreseeable future. The vicinity of the city to major ports (e.g. Kandla and Mundra) also lowers down the transportation costs and thus helps exporters of ceramics from

this region. The region will surely be one of Asia's key driving forces over the next 10 years. At present there are around 600 ceramic wall/ floor/ vitrified tiles manufacturing units in and around Morbi and this number is increasing day-by-day resulting into a fierce competition among the active players of this industry. Besides, levy of GST and increasing cost of raw materials due to other external factors have also affected the profit making capacity of these units, which earlier used to be significantly high.

2. MAJOR TYPES OF TILES

2.1 The word 'Ceramic Tiles' is a generic word which includes:

i. Ceramic Tiles.

ii. Ceramic Vitrified Tiles.

iii. Porcelain Tiles.

iv. Laminam or Thin Porcelain Tile.

2.2 Ceramic tiles can be glazed or unglazed. Glazed tiles are available in plain or decorated and can be used on walls and floors. Unglazed ceramic floor tiles are more suited for commercial and industrial settings, but can also be used in laundries and utility rooms.

2.3 Ceramic tiles can also be segmented into Floor tiles and Wall tiles. Floor tiles are generally thicker, larger and more porous than wall tiles. Floor tiles are generally of three kinds (i) Ceramic Floor Tiles (ii) Porcelain Tiles and (iii) Fully Vitrified tiles (Granito). The manufacturing processes of wall tiles and floor tiles are also different. While wall tiles are double-fired, the floor tiles are single-fired.

2.4 Porcelain tiles/ Vitrified Tiles are ceramic tiles, but with a very low absorbency. They are usually made from kaolin clays, feldspar, silica and colouring oxides and are fired at about 1200 °C. These tiles are hard wearing and can be used on walls or floors as well.

2.5 The breakthrough development in tile manufacturing has come with the monocottura technology, which in Italian means single-fired. This process shapes, fires and glazes tiles in one step. Tiles, which had to be baked in kilns for days together in the premonocottura era, can now be produced in less than an hour. Thus, the time of production has been drastically reduced, resulting in sizeable savings in the cost of production. The monocottura tiles also have better density and harder glaze than tiles produced by other methods.

3. CLASSIFICATION OF POTTERY

3.1 Terra-Cotta: The articles made of common clays, dried and fired dense at about 900 °C into utility articles come under this category. Such articles do not come under the classification of low temperature pottery and they are not glazed, keeping their natural colour, mostly red of different shades after baking. Bricks, tiles, pipes, pots and pans and other unglazed wares of common clay belong to this category.

3.2 Earthenware: The articles made of either common red clay of higher plasticity or white burning clays, or an admixture of different types of clays and fired at 950 °C to 1150 °C are classified as Earthenware. Sometimes, a small percentage of fine glass powder is also added. Generally, these articles are glazed, making the porous body impervious on its surface. The green goods are baked at about 900 °C before they are glazed. They belong to the category of medium temperature pottery.

3.3 Stoneware: As the very name suggests, stoneware articles are stone hard, made with dense bodies. Plastic white burning clays such as ball clay and fire-clays are commonly used, but the use of china clay is negligible. Stoneware resemble porcelain, as the texture of both is vitreous and glossy, though it is easier to shape the stoneware bodies, and they are less fragile and brittle in the green stage. Stoneware is fired between 1250 °C and 1300 °C, and they come in the category of high temperature pottery.

3.4 Porcelain: Porcelain is made up of a mixture of various white burning clays and fluxes. Thin porcelain wares are translucent and they are necessarily vitrified as their clay body and glaze fluid mix together. Thin porcelain produces sonorous sound. Porcelains are 99% impervious. Following sub-categories of porcelain exist:

i. **Low-fired Porcelains**: Their body matures at a comparatively low temperature of 1150 °C to 1280 °C.

ii. **Medium-Fired Porcelain**: They are also called soft porcelain. These are just above the stoneware in quality. Dinnerware and decorative-ware as well as electrical porcelain and Parowan porcelain for statues fall in this category. They are fired at 1300 to 1350 °C.

iii. **High-Fired Porcelain:** They are hard porcelain and the temperature at which they are fired is between 1350 °C to 1450 °C.

iv. **Bone-China:** Bone-china or phosphate porcelain is mainly composed of calcined bones. In this case, translucency is obtained at a low temperature. However, the body is fired at the temperature of 1200 °C, while glazing is done at 1100 °C only.

4. RAW MATERIAL OF POTTERY: CLAY

4.1 The most important raw material for pottery is clay. It is disintegrated and decomposed rock, consisting mainly of (i) alumina, (ii) silica and (iii) chemically compounded water. "Clay" is formed of finely grounded particles of rocks and some minerals through weathering action of sun, water (of rains or rivers), and wind.

4.2 Qualities of Clay: The essential qualities which make clay suitable for pottery are:

i. Plasticity.

ii. Porosity.

iii. Vitreousness.

4.3 Plasticity is property that enables clay to be given shape continuously and permanently without rupture as a result of the application of force. Porosity of clay enables pottery articles to get successfully dried without cracks and warps. Vitreousness is the fusing quality of clay at required temperature that renders an article of pottery hard by making the body particles denser. Common potter's clay having fluxes becomes hard at 700 °C, while pure china clay requires a temperature of, say, 1300 °C for fusion, which will increase the cost of production considerably because of the enormous quantity of fuel required for such a high temperature in the kiln.

4.4 Types of Clay: The following are the types:

i. Primary or residuary clays which remain in the place of rocks from which they are formed, e.g. kaolin, late rite, etc.

ii. Secondary or transported clays which are generally carried away by wind or water to a new location e.g. Fire-clay, ball clay.

4.5 Important types of clays include:

i. **Kaolin or China Clay**: It is called China clay as it was first used in China; it is an amorphous variety of clay available in its purest forms. It is less plastic than ball clays or common clays, and is white or cream-colored.

ii. **Ball Clays:** They are found crudely shaped into balls in England where it was first used. They are sedimentary plastic refractory clays, occurring in surface pockets. They are exceedingly fine-grained having high bonding strength, and their colors vary from white to nearly black. Ball clays have a large proportion of Kaolinite along with a variety of impurities.

iii. **Fire or Refractory Clay:** Its fusion temperature is 1500 °C or more. It is quite plastic to shape on wheels. Most of the refractory clays are used as ball clay.

iv. **Red Clays:** They are also called terra-cotta. They are so called as they burn red or buff-red descending on their iron content.

v. **Shale:** They are moderately hard clay strata which soften and become clay on being exposed to weather. Their plasticity increases with the degree of grinding.

vi. **Loess:** It is windblown clay of the arid regions. It occurs in great beds of considerable thickness, but is used in a small quantity.

vii. **Bentonite:** It is derived from volcanic ash. It has special characteristic of swelling to even five times its dry volume, when mixed with water.

5. MANUFACTURING PROCESS OF TILES

5.1 Processing of Raw Materials

i. Various types of clays and minerals such as Soda Feldspar, Potash Feldspar, China Clay, Ukraine Ball Clay, Zirconium Silicate and Quartz are brought to the factory. The raw materials are then put into a weighing box in a pre-determined proportion to make one charge. Pigments/ ceramic colorants are added to the charge.

ii. The charge is then fed into the Ball Mills through conveyors. Water is added to the charge and the mix is grounded in the ball mills with the help of grinding media. The ground materials in the slurry form are thereafter discharged into storage tanks fitted with agitators to keep the slurry in suspension. From the storage tank, the slip is transferred to another storage tank after sieving. The filtered slurry is thereafter fed to the Spray Dryer Chamber, which is heated up to a temperature of around 550 °C to 600 °C by hot air blast coming from the Hot Air Generator using LNG/ CNG as fuel. The output available from the Spray Dryer is in the form of powder, which is obtained with specific moisture content by adjusting the inlet and outlet temperatures of the Spray Dryer. The powder is collected in the Storage Silos.

5.2 Formation of Tile Body and Drying

The powder is taken from the silos and after sieving on a Vibrator fitted with a magnet, it is fed into the Hoppers of the Hydraulic Press where the powder is pressed in the die to take the shape of a tile of specific size as per the cavity of the die. Green tiles coming out of the press are sent to the Horizontal Roller Dryer where they are heated to a specified temperature to remove the moisture.

5.3 Preparation of Designs and Digital Printing of Tiles

In the Glaze Line and Printing Section, various types of designs are prepared and printed through digital printer by applying various ink. Tiles with digital printing need to be screen printed, whereas other types of tiles may not be subjected to this operation.

5.4 Firing

The tiles thereafter are fed into the Fast Single Layer Roller Kiln in which the tiles are fired at. The Kiln has different temperatures ranging from 500 °C to 1400 °C in its different zones. Here, nitrification takes place in the body of the tile.

5.5 Polishing

The baked tiles are subjected to polishing by using polishing line. The tiles are also side-chamfered. Thus, in this Section , size and thickness variations are minimized. Matt finish tiles do not need polishing operation.

5.6 Sorting & Packing

The polished tiles are subjected to quality checking and sorting, where an operator marks out tiles with defects and segregates them into different categories such as first, second and third grade quality. Different grades of the finished tiles are then packed into different types of packing boxes which are marked accordingly. The packed finished goods are thereafter sent for dispatch.

6. CONTROL OF GOVERNMENT AGENCIES

6.1 There are certain other Government Agencies apart from Income-tax Department having details of Ceramic units and data regarding their consumption pattern of raw material and power consumption which may be obtained from them, like:

i. GST Authority.

ii. Electricity Companies.

iii. Quarries, etc.

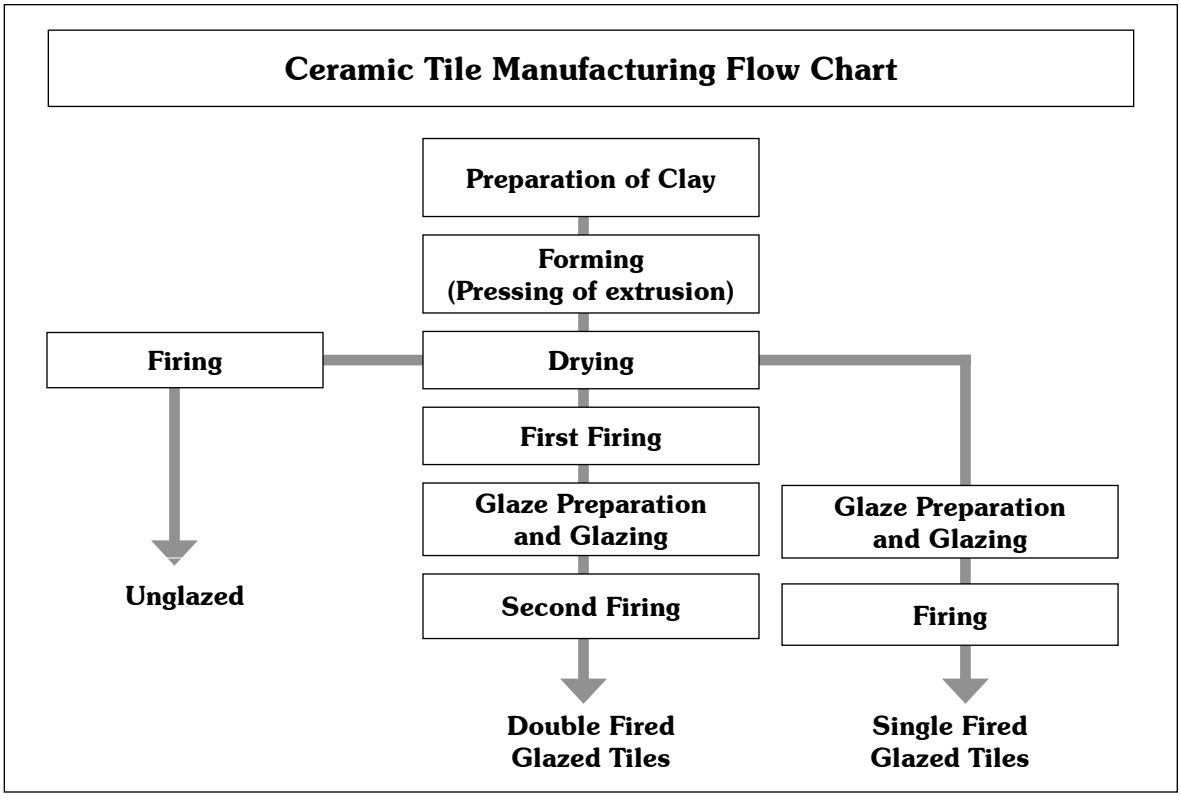


Fig. 1

6.2 The details so obtained from these agencies can be compared with the day-to-day production, sales and consequent accounting thereof. Although stones and clays are supplied to the manufacturers generally by contractors who take the quarries on lease, some of the bigger units acquire quarries of their own and exploit them. These quarries are obtained from the government of the respective state, under a contract or license or on payment of royalties during the period of exploitation. These royalties are determined on the basis of total quantity of material exploited over a period. Therefore, the quantity of material taken out of a particular quarry by the manufacturer during a particular period can give useful hints about the consumption of the raw-material.

Similarly the production and comparative sales can also be verified with reference to the Electricity & Fuel (Coal & Gas) consumed, which varies based on the type of product the unit manufactures.

7. TAX INVESTIGATIONS

7.1 Capital

i. Ceramic Industry is a Capital intensive industry. It requires huge amount of investment to purchase heavy machineries which are most of the times imported from China or European countries.

ii. For this purpose, the promoters/ investors mostly rely partly on borrowed funds from banks and partly on capital and unsecured loans from relatives and other third parties.

iii. Mostly it has been observed that the money is introduced as unsecured loans from relatives (from the persons who do not have any substantial capital). Common Modus Operandi which has been observed over a period of time is that these individuals deposit cash into their bank accounts and issue a cheque of same amount in favour of the borrower ceramic unit.

iv. Search and Seizure actions in some regions *viz.* Kolkata (W.B.) have revealed that the unaccounted income earned has been introduced in the books of Firm/ Company by the promoters under the garb of introduction of Share Capital; unsecured loans by the relatives, issue of shares at higher premium and at times through bogus claim of LTCG which is exempt under Section 10 (38) of the Income-tax Act.

7.2 Depreciation

i. As discussed hereinabove, setting up a manufacturing plant of ceramic products requires substantial amount of capital to purchase heavy machineries which are generally imported from China or European countries.

ii. Depreciation expense occupies major part of the direct expenses of such units. Hence, it becomes very critical to verify the veracity of the claim of depreciation made by the manufacturers keeping in mind following check points:

   a. Whether it is new machinery or a used one (with the help of supporting documentary evidence).

   b. Exact date of installation and put to use of the same can be checked by observing sudden hike in the electricity and fuel consumption as result of the installation of new machinery.

   c. Genuineness of additional depreciation claim in respect of new machinery, if made, is also to be ascertained keeping in mind the various conditions laid down in the Act to claim such additional depreciation.

7.3 Raw Material

i. A number of raw materials are used in the production of ceramic products like clays, feldspar, quartz and other stones, glazes, etc. The ratio of these components used in production of different kind of tiles may vary according to the nature of the base product. The raw material consumption ratio can be compared with the ratio declared by other manufacturers engaged in the same line of business. Alternatively, reference of the consumption ratio declared by the same manufacturer in earlier years can also be referred to check any unusual variances.

ii. The purchase bills recorded on the books should be tallied with the entries made at the weighbridge from time to time. Further a list of major suppliers of

raw material and other items should be obtained and inquiries should be made under Section 133(6) of the Act.

iii. The purchasing pattern can also be identified and quantity-wise verification of input & output of raw material vis-a-vis production reported may be carried out.

iv. Besides the clay and glazing mixture, the other pigments and colorants are required for graphics/ designs on ceramic items. The purchases are mostly from local dealers from whom relevant details can be easily obtained and verified.

v. Price of important colors and chemicals are usually reported in economic journals. Therefore, a comparison with the prevailing market rates can easily be made.

vi. Since special colors and chemicals are very costly, a tight control on record of day to day consumption and accounting of receipts and issue will obviously be kept by the management. Issue of these items will also be related to the number of items prepared out of the material so consumed.

vii. Hence, Consumption/ Production Registers should be called for and checked.

viii. Figures of production as furnished by the assessee should be tallied from Production department to Finishing and Packing departments.

ix. Many Ceramic tiles manufacturing units have their own spray dryer unit located away from the factory. At times it is seen that such manufacturers indulge into manipulation of prices for dry powder purchases and thereby lowering the profit margins.

x. Further in case of the raw material which is obtained through mining, it must be verified whether the payment is made through banking channel or not. It may also be desirable to conduct some field enquiry regarding the agents who supplies the basic raw material obtained through mining which is reflected in the regular books of account.

7.4 Power and Fuel

i. Power & Fuel represents substantial part of the operating cost of ceramic manufacturing units. Uninterrupted supply of Power & Fuel is very much necessary for any ceramic unit to maintain its profitability. Power & Fuel expense comprises of mainly three items LNG/ CNG, Electricity and Coal.

ii. There are fewer chances of booking higher expenses for Gas or Electricity expenses as they can be easily monitored with the help of bills and units provided by the Gas or Electricity Company. However, the Coal expense is highly prone to misreporting. It is seen in many cases that assessee books very high power and fuel expenses so it is required to inquire into the same with a view to check such misreporting.

iii. The comparative analysis of Production of Finished Goods and Fuel consumed (based on Quantity) can serve as an effective tool to identify the quantum of suppressed production.

iv. The expenses incurred on power and fuel found at an average rate of 20% to 30% (which is indicative only) of the total expenses incurred normally and hence it has huge implication on the profitability of the concern. It is required to compare the ratio of current year with that of the preceding years to find out any deviation in respect of unaccounted production.

7.5 Sales

i. Sales can be observed by using the following 2 × 2 matrix:

Table 1

	Manufacturing Activity	Trading Activity
Domestic Market Sale	XXX	XXX
Export Market Sale	XXX	XXX

ii. Domestic sales by manufacturing units are mostly through dealers and stockist on commission/ discounts basis. It must be noted that certain discount is always allowed by the manufacturer as well as by the stockist to account for possible breakages in handling and are mostly adjusted in the bill itself. Any separate claim on that account should be examined carefully because the same may be for sales contracted outside of the books.

iii. Moreover, the Sale price charged may be compared with the price of similar items in market. The figure of sales reported should be verified with reference to the sales reported to the GST authority.

iv. If any incidence of frequent and abnormal cash deposits in bank accounts of the partners/ directors/ family members of key persons is found then it may be indicative of out-of-book transactions which require deep investigation.

v. It is generally observed that the manufacturers *suppress* the *sales by showing lesser* MRP in the sales invoices than the actual MRP. The differential value is normally collected in cash from the dealers and such cash amounts are not accounted for in their statutory records.

vi. The recipient dealers and distributors also may not reflect on records, the actual expenses incurred by them towards local transportation, transit insurance, loading and unloading expenses, actual margin of profit etc. These expenses are also meted out by them in cash from the suppressed sales. While part of the cash amount collected by the dealers and distributors in the aforesaid manner is spent by them towards meeting the undeclared expenses as mentioned above, the remaining cash amounts are transferred by them to the manufacturers.

vii. In order to transfer such cash amounts from dealers to manufacturers, different methods are adopted by them. Further, to keep manufacturing cost within range of artificial value, declared in the Tax Invoices, the manufacturers procure number of raw materials either on cash payments or by not showing actual value in the books of account.

7.6 Closing Stock

i. Principles for accounting the closing stock are the same in this industry as in others. It will be necessary to call for details of weight, number of pieces of different items with quantity-wise breakup and also value thereof and the same should be compared with the value shown by the assessee in respect of his purchase and piece-wise sale price and stage at which the particular item has reached in its manufacturing process.

ii. In the Ceramic Industry, it is noticed that the valuation of closing stock is maintained in following manners:

   a. Raw Materials.

   b. Semi-finished Products.

   c. Finished Products.

   d. Broken tiles.

iii. The value of raw material is shown on the basis of purchases made. However, the valuation of semi finished/ finished and

broken products are shown in the books on the basis of certificate of assessee as certified by the Auditor. As such, there is scope of under-reporting of valuation of Semi-finished and finished products. This aspect should be properly examined by the Assessing Officer while examining the consumption ratio declared by the assessee.

iv. Details of the weight, number of pieces of different items with quality-wise breakup and also value thereof should be called for as these need to be compared with the value shown by the assessee in respect of his purchase and piece-wise sale price and stage at which the particular item has reached in the manufacturing process.

v. The valuation of the stock from the report of a registered valuer is important as it requires technical expertise.

7.7 Profit Margin and Ratio Analysis

i. It will be worthwhile to examine carefully the proportionate consumption of different factors of production. For various comparative inputs and yield ratio, a cross reference may be made to data available from the ceramic units operating in the same line of business and have similar products.

ii. There are certain standard ratios in various factors of productions, yield and breakages and if the quantitative analysis discloses some abnormal variations, the assessing officer should be alert because the raw-material expenses might have been inflated, quantity of finished products suppressed and rejections, wastages and breakages exaggerated.

iii. Typically, raw material, power and fuel costs are the main operating costs for any ceramic tile manufacturing unit and account for almost 25–30 per cent of the total expenses incurred. The significant rise and fall in fuel and raw material prices should be taken into account while assessing the profitability of any ceramic unit during assessment.

iv. Normally, the gross profit ratio varies from 18% to 25% whereas net profit varies from 2% to 5%. Any abnormal variance from this range should be scrutinized keeping in mind the differential nature of the tiles the ceramic unit is producing. Again it should be ensured that sales reported & expenses incurred during last three years should also be compared as yardstick to draw any inference.

v. Number of times it has been observed that during the initial phase of new manufacturing unit, in order to meet the large capital expenditure, huge bank credits are availed to set up the unit and to import heavy machineries. Due to this interest on borrowed fund and depreciation, sometimes the bottom line goes to negative and reports huge losses. Gradually these expenses start reducing, however, the effect of this reduction in expenses does not reflect either completely or partly in the Net Profits(in short NP) reported, which needs to be verified carefully.

7.8 Retailers

i. The Ceramic Industry is associated with the real estate business which covers all across the country uniformly as far as growth and requirement is concerned and the dealers or retailer has its outlets in every big or significant cities of India.

ii. The books of account or the Audit Report submitted by the assessee has long list of a debtors/ creditors which requires verification utilizing various tools i.e. (i) utilizing internet (ii) Just Dial, (iii)

Trade India etc., and by issuing statutory notice under Section133(6) of the Act or by issuing commissions to concerned officials. It will test the veracity of the books of account and sometimes it attracts the provisions of cessation of liability in case of sundry creditor and can be taxed.

8. CONCLUSION

In Ceramics and Pottery Industry, both purchase and sale side of the *P&L* account of the manufacturers are subject to manipulation, apart from regular issues of bogus capital introduction and unsecured loans etc. Assessing Officer can get good insight into the actual modus operandi of manufacturer if they call for details like e-way bills indicating the movement of manufactured products as well as raw material. Inquiries can be initiated by the AOs in respect of parties to whom work has been outsourced. The GST led shift from informal to formal sector has been undergoing. However, it will take some more time to fully formalize the economy of the ceramic industry.

CHAPTER

6

Laminate Industry

1. INTRODUCTION

1.1 Laminate is basically produced by treatment of kraft paper and base paper with certain chemicals at high temperature and pressure. In India the laminate industries are mainly concentrated in Gujarat region but now laminate manufacturing units are coming up all over the country.

1.2 Current domestic market size of laminate is about 20 lakh sheets per month with a compounded market growth rate of about 10%. Further, because of export linked incentives and cheap labour this industry is also doing very well on export front, which is also likely to grow at a much higher rate. Therefore, there is still a demand supply gap for quality laminate sheets and thus the industry is likely to grow further. Presently, the laminate market is still in the hands of unorganized sector because of low technology orientation, high GST incidence on end products and high customs duty on raw-material. Laminates and decorative veneer total market size in India is of around Rs. 6,000 crores with an unorganized market forming around 30% in 2015 as compared to 40% in 2013, reflecting a clear and gradual shift towards the organized market.

2. WHAT IS LAMINATE

2.1 Laminate is basically a paper product which is formed by plasticising paper with chemicals. The final product has properties of plastic. The production of laminates take place in the form of laminate sheets in standard size of 4x8 ft. though recently some units have come up with sheets of 4x10 ft. size. The sheets are produced in various thickness ranging from 0.5 mm to 10 mm. Laminates can be broadly divided into following categories:

i. Industrial laminates.

ii. Decorative laminates.

iii. Special purpose laminates.

Presently 85% of market share of laminate is belonging to decorative laminates, while remaining 15% of market share is with industrial laminates and market for special purpose laminates is almost nonexistent.

2.2 Industrial laminates are used in coach building such as bus coaches, rail coaches and

also as an input in various end products like printed circuit boards in electronic industry, electric panels, etc. Normally, laminates with a thickness of 2 mm and above are termed as industrial laminates.

2.3 Decorative laminates can be further divided into following segments-Premium, Commercial and Popular.

2.3.1 Premium Segment: This segment is quality oriented but has a lower volume. The offerings in premium segment markets are the laminates with thickness of 1 mm and 1.5 mm. The target group of this segment is architects and interior decorators. However, the growth rate in this segment is very sluggish because of high pricing. Even in this premium segment 1 mm thickness laminates are more popular. The premium segment is mainly in the hands of known companies which are also selling the products at higher rates.

2.3.2 Commercial Segment: This segment consists of laminates with 0.5 mm to 0.7 mm thickness. This segment is mainly price sensitive having low quality orientation with very high volume. The market in this segment is evenly spread across the country. The target group of this segment is furniture makers and contractors. Smaller units and unorganized sector of laminate industry mainly cater to the demand of this segment.

2.3.3 Popular Segment: This segment is growing in the market. It offers better quality at lower price by offering thickness of 0.8 mm. It is growing at a fast rate.

2.4 Special Purpose Laminates

As the name itself suggests these laminates are manufactured for special purposes such as fire retardant, port forming (obtaining curvatures), display boards with magnetic properties, etc. The demand as well as production of special purpose laminates in India is almost nonexistent because of lower awareness coupled with high cost.

3. CAPACITY OF UNITS

International standard size of manufacturing units of laminate industry is between 3 lakh to 5 lakh sheets per month. However, in India even the bigger units are having capacity of about 1 lakh sheets per month. While in unorganised sector the average capacity of various units is about 15000 to 20000 sheets per month.

4. RAW MATERIAL

Following main raw materials are used for manufacturing of laminates:

i. Phenol.
ii. Formaldehyde.
iii. Methanol.
iv. Melamine.
v. Craft paper.
vi. Design paper or base paper.
vii. Tissue paper.
viii. P.P. film.

5. MANUFACTURING PROCESS

5.1 The treatment of kraft paper and base paper are firstly treated with some resins for bonding together. Two types of resins are prepared-melamine based and phenol based resins respectively by mixing melamine or phenol with formaldehyde in controlled conditions for few hours in stainless steel jacketed vessels. The resins are prepared in batches. For thinning the phenol resins methanol is used while melamine resins can be diluted by water also for further use. Certain manufacturers in unorganised sectors are also using some urea in the process of preparation of resins.

5.2 Design paper is impregnated with melamine based resins, while kraft paper is impregnated with phenol based resins in impregnation chambers. Such impregnated papers are then dried in thermion fuel drying system during constant movements achieved by rolling.

5.3 Subsequently, the impregnated kraft papers and design papers are cut into required size and they are stocked in air conditioned atmosphere so as to avoid sticking and spoiling. The basic laminate can now be formed by stacking several kraft papers as per requirement of thickness and a base paper/ design paper on the top of them, by further processing. However, quality conscious manufacturers normally put a layer of tissue paper also on the top of base paper/ design paper for better and durable finishing. Further, some manufactures also use a barrier paper between the base paper/ design paper and the kraft paper so as to achieve a proper finish. Such stacks or booklets of kraft paper, base paper and tissue paper are then pressed between stainless steel moulds from both the sides to impart required finishing to the end product. At this stage, the impregnated kraft paper, base paper and tissue paper pressed by stainless steel moulds starts taking shape of a laminate. The sheets so formed are separated by a film to avoid their sticking together.

5.4 Sheets so formed along with Stainless steel press moulds are sent into crazes called daylights through assemblies. On the stacks put up in daylights hydraulic pressure of 3000 PSI is applied at high temperature in a multi-opening hydraulic press where polymerisation and plasticising of papers take place. Such pressure is applied at high temperature approximately for 90 minutes.

5.5 The laminate sheets thus formed are finished by trimming and sanding to give it a final shape, which are finally subjected to quality tests and then sent into godowns. Finally, the finished laminates are packed, labelled and dispatched to the markets.

6. PLANT AND MACHINERY

6.1 The essential plant and machinery in a laminate factory are as follows:

i. **A Boiler** required for producing steam. The steam is required in the process of manufacturing.

ii. **RCC Tower** for water tank and boiler feed water tank.

iii. **Stainless Steel** vessels, at least 2 for making melamine and phenol based resins with gear and electrical motor assemblies;

iv. **Storage Tanks** for raw material as well as resin batches;

v. **Dryers** (3-chambered or 2-chambered) through which the impregnated paper passes for process involving drying;

vi. **Stainless Steel** moulds and the related units for putting Stainless steel moulds between stacks of kraft paper, design paper and tissue paper;

vii. **Hydraulic Press** with several daylights;

viii. **Cutting and Trimming Machines** for finished products as well as for impregnated kraft and design papers;

ix. Effluent treatment plant

6.2 All the above referred plant and machinery is further supported by assembly lines and other fittings, water softening plant with accessories for boiler, sanding machine, press line for laminate, transformer, power supply lines, auxiliary power unit etc. All the machines are indigenous. They are mostly manufactured in Gujarat. For better finish, imported stainless steel moulds are being used.

7. MANPOWER EMPLOYED

Following types of manpower is employed in a typical laminate factory:

i. Factory in-charge/ production manager.

ii. Departmental supervisors.

iii. Laminate units usually have the following departments.

iv. Boiler Department.

i. Resin Production or Vessel Department.
ii. Impregnation Department.
iii. Press Assembly Department.
iv. Hydraulic Press Department.
v. Finishing Department.
vi. Bonded Store/ Packing Department.
vii. Machine operators.
viii. Excise clerk.
ix. Maintenance engineers.
x. Accountant.
xi. Lineman.
xii. Security man.

8. APPLICABLE STATUTES

Besides the Sales Tax, Central Excise and Customs and Income-tax Acts, depending upon the constitution of the laminate manufacturing unit, the following industrial and other laws apply:

i. The Companies Act, 1956.
ii. Partnership Act.
iii. The Factories Act.
iv. Provident Fund Act.
v. Employees State Insurance Act.
vi. Minimum Wage Act.
vii. Industrial Dispute Act.
viii. Contract Labour Act.
ix. Equal Remuneration Act.
x. Maternity Benefits Act.

The industry is a large scale user of methanol. Wherever state excise laws are applicable for the use, monthly reports of purchase and consumption are required to be submitted to the state Excise Department.

9. FORMS AND REGISTERS

There are a number of forms which are required to be maintained by a laminate manufacturing unit for its business. After the implementation of GST the manufacturers have to maintain certain records and accounts in accordance with Section 35 of the CGST Act 2017. Section 35 of the CGST Act, 2017 provides that every registered person shall keep and maintain, at his principal place of business, as mentioned in the certificate of registration, a true and correct account of:

a. Accounts of stock in respect of goods received and supplied; and such account shall contain particulars of the opening balance, receipt, supply, goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples and balance of stock including raw materials, finished goods, scrap and wastage thereof.

b. A separate account of advances received, paid and adjustments made thereto.

c. An account, containing the details of tax payable, tax collected and paid, input tax, input tax credit claimed, together with a register of tax invoice, credit note, debit note, delivery challan issued or received during any tax period (not required for person paying tax under Section 10].

d. Names and complete addresses of suppliers from whom goods or services, chargeable to tax under the Act, have been received;

e. Names and complete addresses of the persons to whom supplies have been made.

f. The complete addresses of the premises where the goods are stored including goods stored during transit along with the particulars of the stock stored therein.

g. Monthly production accounts, showing the quantitative details of raw materials or services used in the manufacture

and quantitative details of the goods so manufactured including the waste and by products thereof.

h. Accounts showing the quantitative details of goods used in the provision of services, details of input services utilised and the services supplied.

i. Separate accounts for works contract showing:

   i. The names and addresses of the persons on whose behalf the works contract is executed.

   ii. Description, value and quantity (wherever applicable) of goods or services received for the execution of works contract.

   iii. Description, value and quantity (wherever applicable) of goods or services utilised in the execution of works contract.

   iv. The details of payment received in respect of each works contract.

   v. The names and addresses of suppliers from whom he has received goods or services.

10. TAX INVESTIGATIONS

10.1 Under-Invoicing: The incidence of GST on laminate industry is still on the higher side i.e. 18%. Prior to the introduction of GST, Excise+Vat+CST+Cess etc. the laminate industry was attracting around 28 per cent or more on taxes whereas now it will have a lesser slab on its range.

GST on laminates is levied on ad-valorem basis. So, under-invoicing of sale value of laminate is rampant. For under-invoicing, either the thickness or the qualitative grading of the laminate sheets is wrongly reported in the sales invoices.

10.2 Cash Sales: Decorative laminates are mostly being purchased by domestic consumers like architects and furniture makers who make these purchases in cash. If such purchases are made without bills, multiple taxes can be avoided. This suits both manufacturer/ dealer and the customer.

10.3 High Working Capital Requirement: The contribution of cost of raw material in the cost of production is quite high in this industry. It is around 60%. High inventory especially that of design paper is to be maintained so that the continuous availability of designs can be maintained. The average circulation period of capital is approximately 4 months. Thus, in normal running times also the laminate industry requires large accounted funds. To have the funds, the following methods are being employed.

10.3.1 Non-genuine Deposits from Dealers: The marketing of laminates takes place through a network of dealers. Laminate manufacturers show huge security deposits of such dealers in their books of account. Many times, even when the accounts of such dealers with whom continuous cash transactions are also being made are settled, the balance in their names in the books of account are not squared off.

10.3.2 Bogus Sundry Creditors: As described earlier, quite frequently raw materials are also purchased in cash and bills are obtained from third parties and sometimes the cash purchases and regular purchases both are made from the same supplier. In the first situation, since the bills are being obtained from accommodating persons, there is no need to settle their accounts and huge amounts keep standing in their names. In the later situation though the accounts are being continuously settled in cash, again the balances in their accounts keep outstanding.

10.3.3 Non-genuine Loans: The manner in which such non-genuine cash credits in the form of loans are introduced in the books of account

is the same as in any other industry. But this practice is more prevalent in laminate industry due to the requirement for huge funds.

Therefore source of infusion of funds in different modes needs investigation.

10.4 Suppression of Production: It is one of the foremost methods of tax evasion prevalent in this industry. This also results in evasion of GST.

As far as suppression of production and under-invoicing are concerned, there can only be indicators that they are taking place. The best way to tackle them is field action. In the past search and seizure operations were carried out on laminate manufacturers in Gujarat. In all those cases the Department was able to lay hands on documents relating to cash flow corresponding to suppression of production, under-invoicing and purchase of raw material in cash.

10.5 Cash Purchases and Bogus Bills of Purchases: Because of customs duty on all imported raw material required in laminate industry, many traders have emerged who are importing various raw material on a highly under-invoiced import rates, either under OGL or by acquiring import license from the exporters. Such traders/ importers are frequently using intermediate purchase bills. This is commonly known as switching of supplier. For example, base paper/ design paper which is being used in India is imported from European countries (mainly Germany) but such importers are obtaining bills from certain persons based in Dubai and Hong Kong at highly under-invoiced prices. It is quite common for such traders to sell the raw material in cash.

The practice is prevalent in the industry to procure raw material from such importers/ traders in cash and obtain bills from some other accommodating parties. Otherwise also, the laminate manufacturers who are suppressing their production are in need of cash purchases of raw material. Thus, the purchases debited in the books of account require to be examined carefully. A laminate manufacturer can obtain bills of higher quantity of raw material than the actual consumption which in effect will mean introduction of bogus purchases and debit purchase bills of non-existent parties while procuring raw material from some other suppliers. If he is not very careful, the monthly raw material consumption ratios as per the bills will be distorted and will vary to a great extent.

10.6 Underutilization of Capacity: To examine whether a unit is showing substantially lower utilization of its capacity, it is necessary to determine the capacity of a laminate manufacturing unit. The heart of a unit is the hydraulic press with several daylights. The number of daylights in the hydraulic press decides the production capacity of a particular unit. It is the most important indicator of production capacity as well as the volume of production. More or less, all the units work in shifts for all the 24 hours. That is why they are provided with auxiliary power units. In one daylight approximately 16 sheets are processed at a time. The figure of 16 sheets per cycle has been taken on an average as per the market requirement of thickness of sheets. The sheets are pressed in hydraulic press for a cycle of 90 minutes and a complete cycle takes a total time of about 100 to 120 minutes including loading and unloading of new batch and thus in a day 12 to 14 cycles of processing of laminates take place. Thus, a unit having hydraulic press with N number of daylights has an approximate production capacity of N x 16 x 12 x 300 sheets per year (if in an entire year the working days are taken at approximately 300 days). The capacity computed by this thumb rule is also on the lower side since it assumes that only 12 cycles are taking place.

If the actual production of sheets is substantially lower than the capacity of the unit computed in the above manner, then it is a good indicator towards suppression of production by the unit.

10.7 Power Consumption: Another broad indicator of actual production of a unit is its power consumption, which is approximately one unit per sheet on an average. However, the higher power consumption is just an indicator

and circumstantial evidence and no conclusion can be entirely based only on the power consumption.

10.8 Wages Paid: Examination of records regarding wages paid to the workers can be an important tool because such records would give an idea as to how many shifts and how many days the unit was working. This is necessary to counter any argument of the assessee in respect of lower capacity utilization of the unit.

10.9 Analysis of Raw Material Consumption & Actual Production: This can help in identifying and pinpointing manipulations in the manufacturing account. The consumption of various raw materials for different thickness of laminate sheets is quite standard and is accurate to the extent of 85% in most of the raw materials irrespective of any user specifications, order quantity and pattern, quality of raw materials, quality of intermediates, ambient conditions, condition of production equipment etc.

10.9.1 After considering all the relevant factors, following conclusions can be drawn from the analysis of raw material consumption and production:

i. The consumption of melamine is overall the best indicator for finding the actual production of sheets. Melamine attracts GST @18% and is manufactured domestically or imported depending on the requirement. This is because only the top design paper/ base paper is impregnated with melamine based resin. Sometimes, the barrier paper or more than one sheet of base paper or design paper is also used to produce laminates of particular designs but even in such cases only the top layer of design paper is impregnated with melamine based resin. The consumption of melamine will double for double sided laminates which are normally produced in higher thickness laminates i.e. 1.5 mm and above.

ii. Consumption of kraft paper and phenol are directly correlated with each other. Kraft paper and phenol attract GST @12% and 18% respectively. Kraft paper is mostly available domestically however phenol is imported by certain laminate manufacturers. Higher actual consumption of both the kraft paper and phenol together along with normal actual consumption of melamine indicates that more of higher thickness sheets are being produced instead of reported production of lower thickness sheets, and thus, finally under invoicing is taking place by changing the grade of sheets in sales invoices.

iii. Higher consumption of all the raw materials together again indicates suppression of production. Higher actual consumption of only some raw material indicates presence of accommodation bills or bills of bogus purchases corresponding to such raw material.

iv. In case a particular unit is producing special effect laminates such as sandwich laminates having several design papers in the middle of the laminate or coloured side of finished laminates having multiple layers of design paper, then such special effect laminates will have a very high consumption of base paper. Thus, in case the production of a manufacturing unit include production of any such special effect designs, then any conclusion only on the basis of consumption of base paper will become erroneous. However, any increase in consumption of base paper being explained by a unit on the basis of such design would mean corresponding lower consumption of kraft paper.

v. Analysis of raw material consumption with actual production can be done on monthly basis also by computing the standard consumption of raw material

for the production achieved in every month and its comparison with actual raw material consumption. More or less, the consumption of raw material on monthly basis shall also match with the standard consumption, if the work-in-progress is more or less the same. If there are large scale variations in monthly consumption of raw material and standard raw material consumption which are not explained by way of the work-in-progress, the case requires detailed investigation.

10.9.2 In one case on computing the standard raw material consumption on monthly basis for the production of the assessee and its comparison with actual consumption of raw material, it was found that in the month of April, actual consumption of the raw material was substantially higher than the standard consumption. Importantly such higher consumption of various raw material was also linked with each other in a manner which clearly showed that in the month of April the production was substantially suppressed.

10.10 Excessive Claim of Depreciation: Though laminate is a paper-based industry, some manufacturers claim that the industry is covered under the head 'plastic and rubber industry'. Accordingly, they claim depreciation on Stainless steel plates at 40% instead of at 25%. It is pertinent to mention here that many manufacturers themselves claim depreciation at 25% only which is the correct rate. A check on this aspect at the time of the assessment is necessary.

10.11 It is quite common for laminate units to claim deductions under Section 80HH and 80-I of the Act. These claims should be subjected to normal checks before acceptance.

11. CONCLUSION

The dominance of unorganized sector in this industry makes it susceptible to all those tax evasion methods which are common to any industry operating in unorganized sector. Laminates are available in wide variety. The manufacturing process of different varieties of laminates differs slightly but the difference in market price is substantial. This feature in the industry increases the likelihood of manipulation of accounts and under invoicing. As certain raw materials used in this industry are imported the assessing officers should thoroughly investigate the quality, quantity and price of imported purchases. Profit margin and ratio analysis are useful tools for ascertaining the genuineness of claims made by any laminate manufacturer. For quick comparison of profit margin and other ratios AOs may also make comparison with the figures declared by established players in this industry, who are selling products with quality assurance certificates from independent third parties. Many of the established players in this industry are listed and their financials and other details are easily available in public domain.

CHAPTER

7

Real Estate Business

1. INTRODUCTION

1.1 The real estate business in India stands at second number after agriculture in terms of employment. Therefore, the government of the day has thought it appropriate to regulate the industry by bringing in new regulatory mechanisms and instruments.

1.2 A structural reform designed to bring about a paradigm shift in the way the real estate sector operates is the introduction of the Real Estate Regulatory Authority (RERA), which will help in improving transparency and efficiency, restore consumer confidence and revive demand.

1.3 The relaxation of Foreign Direct Investment (FDI) rules for the real estate sector, opening up of the domestic fund industry to foreign investment, introduction of institutional frameworks like the Real Estate Investment Trust (REIT) and Infrastructure Investment Trust (InvIT) are expected to help raise funds to support projects and accelerate growth. However, the REITs & InvITs have also to take off in real terms to have a perceptible impact.

2. NATURE OF BUSINESS

2.1 Real estate business is a capital-intensive activity. Most of the activity is at the site. Usually an office is maintained at the site and the records are kept in that site office. Construction activity usually consists of the following broad stages:

i. Site investigation—Site investigation involves soil testing and study of ground structure. Load-bearing quality and stability of the ground is very important for construction of big buildings.

ii. Preparation of plans, drawings, specifications and other architectural and engineering date for building the superstructure.

iii. Selection of appropriate building materials *viz.* cement, steel, sand and other materials.

iv. Laying of the foundation for the superstructure.

v. Raising of concrete columns and building the walls with brick and masonry work.

vi. Laying of pipelines for water, sewage systems.

vii. Laying of conduit pipes for electric wiring for lighting, lair conditioning etc.

The cost of the materials and labour etc. are major components of the total cost of the project.

3. ACCOUNTING METHODS

3.1 The Accounting Standard 7 (AS-7) issued by the Institute of Chartered Accountants of India states that there are two methods of accounting for construction contracts:

i. Completed Contract Method.

ii. Percentage of Completion Method.

AS-7 says that the principal problem relating to accounting for construction contracts is the allocation of revenues and related costs to accounting periods over the duration of the contracts.

3.2 Completed Contact Method: The completed-contract method recognises income only when the contract is completed or substantially completed. It is employed by assessees having low turnover. Through this device the disclosure of income of substantial amount was postponed. It may be mentioned that the International Accounting Standards Committee has revised the International Accounting Standard (IAS 11) and scrapped the completed contract method and has suggested the percentage of completion method for adoption.

3.3 Percentage of Completion Method: Under the percentage of completion method, revenue is recognised proportionately with "the extent of work accomplished" by the contractor/ builder. Section 43CB of the Act inserted by Act No. 13 of 2018 w.e.f. 01/04/2017 is relevant in this regard.

The computational formula for the Revenue to be recognised under PCM is stated, as under:

Revenue for the Current Year = (Cost Incurred, till date/ Total Estimated Cost of Project) * Revenue.

Illustration: Let us assume that an assessee gets a contract worth Rs. 15,00,000/- and the total estimated cost for the contract is Rs. 10,00,000/- If the cost incurred in the first year is Rs. 3,00,000/- The cost percentage works out to 30% (Rs. 3,00,000/ Rs. 10,00,000/-)

So, the Revenue to be recognised in the first year will be 30% of Rs. 15,00,000/-, which works out to Rs. 4,50,000/-. Thus, the profit for first year is worked out as under:

Profit for First Year

= Rs. 4,50,000/-minus Rs. 3,00,000/-

= Rs. 1,50,000/-

In the second year, assume that the estimated cost of the project escalates to Rs. 12,00,000/-. If the cost incurred till the end of the second year is Rs 6,00,000/-, the cost percentage works out to Rs. 6,00,000/ Rs. 12,00,000 = 50%.

Thus, the revenue to be recognised is (50% of 15,00,000 minus Rs. 4,50,000/-, Revenue already recognised), which works out to Rs. 3,00,000/-. The cost for the second year works out to Rs. 3,00,000/- (Rs. 6,00,000/-, cost till date minus Rs. 3,00,000/-, cost already recognised).

The profit for second year is worked out as under:

Profit for Second Year

= Rs. 3,00,000/-minus Rs. 3,00,000/-

= Rs. Nil

In appropriate cases where the accounting method employed by the assessee doesn't give correct taxable profits and the case is big and complicated, the AO may consider reference for Special Audit under Section 142(2A) of the Act. However, in smaller cases, the AO should reject the books of account under Section 145 of the Act and make a best judgment assessment.

4. TRANSFER OF IMMOVABLE PROPERTIES BY WAY OF SALE OF SHARES OF A COMPANY

4.1 A large number of instances have come to the notice of the Department, wherein Private Limited companies have sold immovable properties by resorting to the technique of transferring its shares at below the fair market value. The shares being unquoted are generally transferred at face value, which is much lower than the market price, resulting in the transfer of majority of the shareholding from the sellers to the buyers. On this issue, the Assessing Officers should note that the Finance Act, 2017 had w.e.f. 01/04/2017 inserted Sub-clause (c) of Clause (x) in Section 56(2) which states that if any person receives any property without any consideration or for inadequate consideration, he shall be subject to tax. It may be clarified here that the word "property" mentioned in the said Section includes "shares and securities".

4.2 Further, the Finance Act, 2017 had w.e.f. 01/04/2018, introduced Section 50CA to provide that where consideration for transfer of shares of a company other than a quoted share is less than the FMV of such a share, the FMV determined as per the Rules shall be deemed to be the full value of consideration for computing income under the head "capital gains."

4.3 On 12 July, 2017, the Central Board of Direct Taxes (CBDT) has issued the Rules for the determination of fair market value (FMV) of unquoted equity shares for the purposes of Section 56(2)(x) and Section 50CA of the Income-tax Act, 1961.

4.4 In such case, the AO shall determine the fair market value of such unquoted shares as per Rule 11UA(1)(c)(b). Further, the amount of understatement of such consideration shall be worked out by the AO and added back in the hands of the seller of the unquoted shares, under the head "Capital Gains", as per the provisions of Section 50CA of the Income-tax Act, 1961.

4.5 Also the purchaser of such shares needs to be taxed on such amount of understated consideration, as per the provisions of Section 56(2)(x)(c) under the head "Income from Other Sources". Thus, where there is a transfer of immovable property without consideration (stamp duty value of which exceeds Rs. 50,000/-), stamp duty valuation will have to be taken into consideration and the difference between stamp duty value and consideration paid would be liable to tax. It may be noted that land or building or both would include all types of rights attached to immovable property such as FSI, TDR, shares with occupancy rights.

5. ISSUE OF ON-MONEY DETECTED DURING THE COURSE OF SEARCH

5.1 During the course of search operation in case of the Real Estate Developers, usually a large number of incriminating documents are found relating to charging of on money on the sale of flats/ properties. In such incriminating documents, generally the information is written in a coded form, which needs to be deciphered in a proper manner. For example, if on a seized page "40% in C" is written, a logical inference may be drawn that 40% of the sale consideration has been received in cash.

5.2 Also, during the course of search and survey operation, the information about charging of unaccounted on-money in cash is found for only part periods. In appropriate cases, if the facts suggest, the existence of the business practice of charging of on-money throughout the year can reasonably be presumed following the ratio laid down by the Hon'ble Supreme Court in the case of *CST vs. HM Esufali, HM Abdulali* (1973) 90 ITR 271(SC).

5.3 The Assessing Officer for investigating all such cases of on-money should follow a systematic and organized approach. Firstly, the data of booking of all the flats/ plots, as per the regular books of account should be arranged date-wise along-with the rate charged. It is pertinent to note here that the data should be arranged on the basis of the date of allotment of the immovable property and not on the basis of the date on which the immovable property is registered, as the actual rate at which transaction is carried out is finalized at the time of allotment/ booking and the on-money is also generally charged at the time of booking/ allotment of the property. If there is substantial variation in the rate of booking of the flats/ plots in a particular period, it prima-facie indicates that the assessee might have charged on-money.

5.4 As a second step, the actual rate of the flats/ plots should be worked out. The data relating to the actual rate of the flat can be easily obtained from various brochures, advertisements, website, project launch documents, seized documents etc. of the assessee. To work out the actual base rate of the flats, the extra rate charged for floor-rise, view premium etc. should be removed.

5.5 Lastly, as a third step, the difference between the actual base rate and the rate recorded in the regular books of accounts should be worked out. This exercise should be done for all the flats for which booking is being done by the assessee. The existence of the business practice of receipt of on money throughout the relevant years can be reasonably presumed, if the above factual data supports the view. For example, if the base rate of a flat in a project is Rs. 15,000 per square feet and a flat is booked in the regular books of accounts at Rs. 12,000 per square feet. Then, the on-money for the flat works out to Rs. 3,000 per square feet. Thus, on money should be calculated for each flat by using the actual base rate of Rs. 15,000 per square feet.

5.6 It has been observed that Assessing Officer, while quantifying the on-money, usually applies a flat GP rate on the total turnover, which is factually and legally not tenable. The GP rate addition is not tenable in law especially in search cases, where assessments under Section 153A/153C are to be made on the basis of seized incriminating documents only. Thus, the on-money should be worked out by following the above explained approach.

6. TREATMENT OF ON-MONEY/ UNDISCLOSED RECEIPTS

In the case of large Builders and Developers, 8% of the on-money is being offered for taxation before the AO, Appellate Authorities & ITSC by relying on the provisions of Section 44AD of the Act. The 8% presumptive rate mentioned in Section 44AD of the I.T. Act 1961 cannot be applied in the case of Big Builders and Developers, because the provisions of Section 44AD are applicable only to "eligible business" which are defined as business not having a turnover of more than Rs. 2 Crores. The provisions of Section 44AD are applicable only to "eligible assessee" namely, individuals, Hindu Undivided Families and partnership firms and not to companies. The provisions of Section 44AD of the Act are not applicable to contractors and builders. Ordinarily, the entire amount of on-money is to be treated as taxable income and no expenses should be allowed.

7. EXPENSES FALLING UNDER EXPLANATION TO SECTION 37 OF THE ACT

In the case of developers and builders, it has also been noted that documents are invariably found during the course of search operation wherein illegal payments made to State Governments officials, Local body officials, tehsildars, patwari,

Registrars, licensing authority etc. are noted. In such case, the Assessing Officer should disallow these expenses, as such payments are hit by Explanation to Section 37 of the I.T. Act 1961.

8. TAXATION OF COLLABORATION AGREEMENETS/ JOINT DEVELOPMENT AGREEMENTS

8.1 In a collaboration agreement, the owner of the property enters into an agreement with the builder/ developer, who removes the old property and reconstructs a new one. Out of the newly constructed property, a part is kept by the owners and rest is taken away by the builder. The land right that is sold by the owner is a capital asset under the Income-tax Act 1961 and attracts capital gain on sale. However, the owner of the property can claim deduction under Section 54F of the Act, if the prescribed conditions are satisfied.

8.2 Under the existing provisions of Section 45, *capital gain* is chargeable to tax in the year in which transfer takes place except in certain cases. The definition of 'transfer', inter alia, includes any arrangement or transaction where any rights are handed over in execution of part performance of contract, even though the legal title has not been transferred. In such a scenario, execution of Joint Development Agreement between the owner of immovable property and the developer triggers the capital gains tax liability in the hands of the owner in the year in which the possession of immovable property is handed over to the developer for development of a project. Before 01/04/2018, the position of law is that where possession or part possession of immoveable property is given by the land owner to the developer that would trigger the transfer under Section 2(47)(v) of the Act, as on the date of handing over the possession, irrespective of the fact whether the title has been transferred or not.

8.3 With a view to minimise the genuine hardship, which the owner of land may face in paying capital gains tax in the year of transfer, a new Sub-section (5A) in Section 45 has been inserted w.e.f. 1.4.2018, so as to provide that in case of an assessee being individual or Hindu undivided family, who enters into a specified agreement for development of a project, the capital gains shall be chargeable to income-tax as income of the previous year in which the certificate of completion for the whole or part of the project is issued by the competent authority. For, the owner of the immovable property, the Stamp duty value of land or building or both as on the date of issuance of completion certificate increased by any consideration received in cash, shall be the full value of consideration for the computation of Capital Gains. The full value of consideration would be regarded as cost of acquisition in the hands of land owner in the developed property and would be allowed as a deduction on subsequent transfer of the developed property by the land owner in the proportion of the area sold. It may be noted that provisions of Section 45(5A) applies only to a specified agreement entered into by individuals and HUF and does not apply to companies, LLP and any other non-corporate entities.

9. TAXATION OF TRANSFERRABLE DEVELOPMENT RIGHTS

9.1 The concept of TDRs originates from the regulation of "Development Control Regulation of Greater Mumbai'' i.e., "DCR, 1991", wherein it was provided that the owner or a lessee of a plot, which was reserved for public purpose under the development plan of DCR, would be eligible for award of compensation by way of development right certificate of equivalent Floor Space Index (FSI).

9.2 In other words, the Govt. decided to grant Transferable Development Rights to the land owners, who agreed to surrender their lands on FSI for public purposes. These TDRs can be transferred to other land owners or building for constructing of the building or additional floors. The plots on which those development rights could be used were termed as "Receiving Plots" and on these plots in addition to whatever FSI were originally available to the owner or lessor of such plots, additional FSI can be allowed to the owner or lessor on using the transferable development rights contained in DRCs for the purpose of construction of the building.

9.3 Development right in a property is also a property by itself and would be included in the expression 'capital asset'. The term 'property' as stated in the definition of 'capital asset' under Section 2(14) does not merely mean physical property but also includes rights, title or interest in it and that ownership of land carried with it bundle of rights attached to it, of which the right of development is most important one.

9.4 A 'capital asset' means property of any kind held by an assessee whether or not connected with his business or profession but does not include what is defined under Sub-clauses (i) and (ii) of Section 2(14), namely the definition Clause of capital asset. The words employed in Sub-clause (i) are 'sale', 'exchange', or 'relinquishment' and under Sub-clause (ii) the words employed are 'extinguishment of any rights therein'. The definition is an inclusive definition. The expression must be read widely and not narrowly. It denotes extension and cannot be treated as restricted. Transactions where under the rights to exclusive possession and enjoyment stood transferred, even subject to right to reversion in favour of the transferor would be covered by this Section.

9.5 Thus, such a right is definitely a "Capital Asset" held by the assessee and assignment of such a right in favour of the developer amounts to transfer of capital asset. One view is that even though the transfer of TDR amounts to transfer of a capital asset, the same cannot be subjected to tax under the head "Capital Gain" for the reason that there is no cost of acquisition in acquiring the right which has been transferred and the computational mode given in Section 48, thus fails in the case. However, in case the AO can judiciously work out the cost of the capital asset as on the date of acquisition, the transfer of TDR may be taxed.

10. AMOUNT RECEIVED ON SURRENDER OF TENANCY— CAPITAL GAINS

The term "Long Term Capital Asset" is defined in Section 2(29A) of the IT Act, 1961, as an asset which is not a short term capital asset and the "short term capital asset" is defined in Sec. 2(42A) to mean a capital asset held for not more than 36 month immediately preceding the date of its transfer. The expression "held by a assessee" means the date from which the assessee acquired the right or got hold of and started enjoying the assets. The word "held" in Sec. 2(42A) is not confined or restricted to just ownership of the property or of an assets. The term "capital asset" as defined in Section 2(14) of the Act and means property of any kind held by an assessee. Thus, the term "capital asset" has a wider connotation and includes not only the ownership right in an asset, but also leasehold rights, allotment rights, tenancy rights etc.

11. TAXATION OF ALV OF STOCK-IN-TRADE

The provisions of Section 23(5) of the Act are hotly debated, nowadays especially in respect of

newly constructed unsold flats by the Builders and Developers. The provisions of Section 23(5) of the Act introduced by Finance Act 2017, w.e.f. 01/04/2018 are more clarificatory in nature and states that the incidence of tax on account of annual letting value of the stock in trade, would arise only after a period of one year from the end of financial year in which certificate of completion of construction is obtained from the competent authority. Meaning thereby, that notional rental value of the stock in trade, is taxable and it is exempt from taxation for only a year, after the completion certificate is received. Thus, the provisions of Section 23(5) of the Act provides a breather for a year only for Builders and Developers. However, the Standard deduction would be allowed under Section 24(a), while computing notional income of unsold flats held as stock-in-trade.

In *CIT vs. Ansal Housing* (2016) 389 ITR 373 (Delhi)(HC) and in *CIT vs. Sane and Doshi Enterprises* (2015) 377 ITR 165 (Bom.)(HC), it has been held that Sections 22 and 23 are applicable to assesses, who are engaged in business of construction of house property and are therefore liable to pay tax on the annual letting value of the unsold flats as "Income from House Property".

12. UNACCOUNTED RECEIPTS ON SALE OF PARKING SLOTS

12.1 In one of the case of a Builder cum Developer in Mumbai, a search operation on the assessee Group revealed that the entire receipts from sale of parking slots was not reflected in the books of account of any of the group concern and the entire amount was siphoned off mainly through cheques and draft taken in the name of bogus concerns. Further, corroborating statements were recorded of the employees of the assessee Group, during the course of search, wherein it was confessed that all these car parking receipts received separately have not been accounted for in the regular books of accounts.

12.2 Subsequently, search under Section 132 was also conducted on the cheque discounter, who has in his statement admitted that he used to deposit the cheques received from the assessee Group in the bank accounts of various dummy concerns operated by him.

12.3 Thus, the assessee Group collected parking charges from customers through cheques in the names of dummy concerns operated by the cheque discounter. These cheques then were given to the cheque Discounter for discounting. The Cheque discounter after deducting commission, used to return back the cash to the assessee group. The dummy concerns in whose names cheques are collected were also identified during the course of search operation and the bank accounts of these dummy concerns were called for, and were examined and investigated in details.

12.4 The Dy. Managing Director of the Appellant Group when confronted with these facts, conceded that the group indeed collected cheques for car parking and got them encashed in the market and offered under Section 132(4) of the Act, an amount of Rs. 107.8 Crores on this account for taxation as his unaccounted income.

13. REJECTION OF BOOKS UNDER SECTION 145 & REFERENCE TO VALUER

13.1 A cardinal principle emerging from leading case laws on the subject is that a reference to the Valuation Officer, for ascertaining the cost of construction, can be made only after the Assessing Officer on examination of books of

account etc. finds that these are incorrect or incomplete or suffer from such defects, that Section 145 gets attracted to the facts of the case. The rationale is that when the assessee is maintaining regular books of accounts along with vouchers and relevant documents, in which no defects have been found, the Assessing Officer has no power to reject the books of account and substitute his estimate of cost of construction for the figure of cost recorded in the books on a day-to-day basis. The stage of making an estimate arises only when serious defects are found in the books of account, which are rejected by invoking Section 145.

13.2 Once books of account have been properly rejected either on the ground of their incorrectness or incompleteness or unverifiability, the Assessing Officer gets powers to estimate the assessee's income in a fair/ reasonable manner. For making such an estimate in a fair/ reasonable manner he can collect such information/ evidence as the facts and circumstances of the case justify, including an opinion of a technical 'expert', as to the likely cost of construction of a building of given technical specifications at the relevant time. Thus, the role of the Valuation Officer in estimating the cost of construction is only of a technical or 'expert' witness as contemplated in Section 45 of Indian Evidence Act.

In this regard, provisions of Section 142A of the Act may be utilized by the Assessing Officer.

14. SOME COMMON DEFECTS IN BOOKS OF ACCOUNTS

14.1 The specific defects in the books of account of builders will vary from case to case, but some common defects that generally exist, and which may be sufficient to justify invoking of Section 145 are, as under:

i. Non-maintenance or improper maintenance of day-to-day records relating to receipt/ issue/ consumption of major building materials, i.e. Stock register and inward/ outward memos.

ii. Non-maintenance or improper maintenance of day-to-day records relating to labour payments and the work done by labour contractors/ mukadams.

iii. Non-maintenance or improper maintenance of records relating to exact specifications of amenities like flooring, tiles, granite, finish, electrical fittings, sanitary fittings, window frames/ doors etc.; extra/ special work done in some flats.

iv. Non-maintenance of records relating to work-in-progress.

v. Non-maintenance of records relating to issue of tenders/ grant of sub contracts for plumbing/ sanitation, electrical fittings, labour supply etc.

vi. Absence of periodic co-relation between disclosed labour charges, consumption of main building materials, and receipt of instalment of sale proceeds of flats.

vii. Inflation of purchases, transportation charges and labour charges, or unverifiability of all/ some of these expenses.

The various Municipal/ Urban Development Authorities have framed General Development Control Regulations under the local Town Planning and Urban Development Acts of the respective States. These contain detailed provisions regulating constructions of buildings in urban areas, under which builders are required to furnish various particulars and obtain sanction of the concerned Development Authority

before commencing and after completing the construction project.

14.2 A wealth of important/ relevant information is usually available with these Authorities which can be made good use of for making a proper examination of the reasonableness of the disclosed cost of construction. The builders have to submit a site plan besides detailed floor-wise plans showing internals height of the building, height of rooms, building elevation, structural calculations with structural drawings, plumbing services with necessary details. All development work has to conform to this permission and any substantial deviation has to be resubmitted for approval under the Regulations. Further, occupancy certificates are issued only after inspection that the buildings conform to the approved plan. Thus, structural drawings giving floor-wise technical specifications, and type/ grade of material to be used, are a potentially significant source of information. These details can be co-related with the quantity/ quality of building material consumption recorded in the books. Some technical specifications of the building can also be obtained from publicity literature advertisements, agreements to sell and conveyance deeds.

15. AFFORDABLE HOUSING—SECTION 80-IBA

This provisions of Section 80-IBA has been inserted by the Finance Act, 2016 w.e.f. 01/04/2017 for giving impetus to affordable housing projects and provides for a deduction of an amount equal to hundred per cent (100%) of the profits and gains derived from such housing projects.

16. BOOKING RIGHTS/ ALLOTMENT LETTER

In *Gulshan Malik vs. CIT* (2014) 223 Taxman 243 (Delhi)(HC), the facts were that the assessee booked a flat and was a recipient of a provisional allotment letter. Subsequently, the transaction was converted in to a written agreement to sell. It was held that even booking rights or rights to purchase apartment or to obtain an allotment letter was acquisition of a capital asset. The Hon'ble Court held that acquisition can be by way of an agreement, arrangement or any other manner. Thus, the booking rights or rights to purchase apartment is a capital right that is transferable.

In *CIT vs. R.L. Sood* (2000) 245 ITR 727 (Delhi) (HC), wherein the investment in a flat irrespective of delivery of possession by the builder has been held to be an investment in purchase of construction of a new flat. Thus, booking rights or rights to purchase an apartment or even a letter giving rights in a capital asset and is transferable irrespective of delivery of possession of the flat.

As soon as an allotment letter is issued and payment of first instalment is made, the allottee obtains a right to hold the property and the period of holding is to be reckoned from the date of allotment. Identification of a particular flat and delivery of possession are consequential acts. The mere fact that possession is delivered later does not detract from the fact that the allottee was conferred a right to hold the property on the issuance of an allotment letter. The payment of balance instalments, identification of a particular flat and delivery of possession are consequential acts that relate back to and arise from the rights conferred by the allotment letter.

17. ACCOUNTING STANDARDS AND COMPUTATION OF INCOME

The provisions of Section 145 (1) of the Act states that Income chargeable under the head "Profits and Gains of Business or Profession" or "Income from Other Sources" shall be computed in accordance with either cash or mercantile system of accounting, which is regularly employed by the assessee.

The Sub-section (2) of Section 145 empowers the Central Government to notify income computation and disclosure standards to be followed by any class of assessees or in respect of any class of income. Accordingly, the Central Board of Direct Taxes (CBDT) under the powers given under Section 145(2) of the Act with an objective of bringing uniformity in tax computation has issued Notification Nos. 87 and 88 both dated 29th September 2016 and Circular No. 10 of 2017.

The Constitutional validity of ICDS (Income Computation and Disclosure Standards) was challenged before the Hon'ble Delhi High Court in the case of *Chamber of Tax Consultants vs. Union of India.* The Hon'ble Delhi High Court, vide order dated 8th November, 2017 has struck down specific ICDS to the extent noted in the said judgment and held them to be ultra vires the Act.

The Finance Act of 2018 has put the matter to rest this judicial controversy by making the ICDS proposals, as part of the Act by making suitable amendments. The objective behind the said enactments was to bring certainty in the wake of recent judicial pronouncement of the Hon'ble Delhi High Court on the issue of applicability of ICDS.

In relation to the real estate business, Section 43CB was inserted with effect from the 1st day of April, 2017. Prior to 01/04/2017, an assessee had an option to choose any method of accounting with the only condition that the same was to be regularly followed by him. However, with the introduction of Section 43CB w.e.f. 01/04/2017, for the construction contracts and service contracts, an assessee now has to mandatorily follow the 'percentage completion method' to compute the profits.

However, if the duration of the service contract is less than 90 days, the Project Completion Method needs to be mandatorily followed. If the service contract involves indeterminate number of acts over a specific period of time, then the straight line method needs to be employed for the calculation of the profits.

However, as per Section 43CB, now the contract revenue shall include retention money. Retention money, being part of overall contract revenue, shall be recognised as revenue subject to reasonable certainty of its ultimate collection condition. This view has also been buttressed in Circular No. 10/2017 (F.NO. 133/23/2016-TPL), dated 23/03/2017 issued by CBDT. The AOs may note that Section 43CB is an important revenue augmenting amendment, as prior to this, all the judicial pronouncement on this issue were against the Department. Also, Section 43CB clarifies that incidental income in the nature of interest, dividend and capital gains shall not be reduced from the contract costs. It may be noted that the provisions of Section 43CB are not directly applicable in the case of real estate developers, BOT projects and leases.

18. TAX INVESTIGATIONS

18.1 Purchases: Among the areas needing investigation, purchases come first. Purchases are usually made by the head office but goods are received and stored at site. In order to keep control, the assessee has to keep proper records. The Assessing Officer can call copies

of Purchase orders, Goods inward register, Suppliers' bills and challans, Stock register, and Ledger containing the account of the supplier for an in-depth verification of purchases. He can use the basic tools of investigation such as cross-verification of copies of account by calling for the assessee's account in the books of the supplier and comparing the accounts entry by entry.

Purchase of land is another important area where builders try to inflate the cost of land through long term planning. As soon as they start negotiation for purchase of large tract of land, they set up a number of sister concerns. The land is shown as first purchased by a sister concern at a very low price. Subsequently when the project is announced, the assessee who is promoting the project buys the land from such sister concerns at a very high price. Thus, a large part of the profit is siphoned off to such sister concerns. The Assessing Officer should investigate this thoroughly and if enough evidence is available, try to assess the entire profit in the hands of the assessee promoting the project. However, if the evidence collected is not sufficient to hold the sister concerns as benamis, it should at least be ensured that the profits earned by all the sister concerns from the transactions are assessed to tax.

18.2 Expenditure: In real estate business, the flats and houses are sold even before they are constructed. Generally they are sold at a unit price, say, Rs. 1500 per sq. ft. Since sales are made prior to the construction of the building, the sale price is based on estimations. Firstly, the cost of land, cost of construction, other overhead expenses are estimated. The assessee for his own benefit maintains the data for each completed project. He may divide the cost of each completed project into cost of material, labour, direct expenses and overheads for his own calculations and estimates.

For the reasons mentioned above, the assessee usually maintains separate accounts for each project. The Assessing Officer should ask the assessee to produce such accounts and verify the same. He can make comparison of costs between different projects such as-cost per sq. ft. or even unit cost for each component of cost e.g. cost of cement or iron or labour per sq. ft. of constructed area.

The Assessing Officer can also make such comparison between different assessees also to see whether there is any inflation or suppression of expenditure in the construction. It is not advisable to make any additions merely based on such comparisons. A successful Assessing Officer has to pursue matters further, e.g. by verifying the purchase or expenditure voucher relating to that particular item and prove inflation or suppression of expenditure beyond any doubt.

Wages constitute a major item of the total cost of the project. Usually labourers are employed by way of sub-contract. The general tendency is to avoid verification of the expenditure under wages as it is time-consuming. However, the assessee may be asked to produce the contemporary evidence such as wages register or muster Roll for verification. Generally, the expenditure on wages would be more in the initial stages and less towards the completion of the project. The following techniques may be used to check the correctness of the claim:

i. Whether the payments are made at regular intervals. Generally wages are paid daily or weekly. Irregular payments may be verified.

ii. Availability of cash—Wages are generally paid by cash. The cash book should be verified to see whether there are adequate balances for making payments. Cash receipts in the site cash book as transfer from head office should be cross-checked.

Look for cash credits introduced to account for payment of wages. If there is an inflation of wages, it is likely that such credits are also bogus.

iii. Wages outstanding—By the very nature of this expenditure, the amount of wages outstanding cannot be more than the average daily wages or the average weekly wages, as the case may be. If the amount of wages outstanding is more, further verification and analysis is required.

18.3 Work-in-Progress: This is a figure which the assessee can manipulate to either suppress or inflate the profits. The usual argument that if the closing figure of work-in-progress is disturbed, the corresponding opening figure of the next year will have to be increased and hence there will be no benefit to revenue, should not deter the Assessing Officer from making proper investigation on this issue, if otherwise called. There is a definite benefit to revenue in that if the tax is not collected, the assessee can postpone his liability perpetually, by the manipulation of the figures of the closing work-in-progress.

The work-in-progress should be valued at least at cost plus percentage of profit. If it is valued below cost, the assessee should be asked to explain and necessary additions should be made, if required. The assessee should be asked to explain the basis of valuation of work-in-progress. Some assessees continue to show a few of the flats in each project as work-in-progress even though the project is completed. Getting the account of each project and work-in-progress separately would prevent such practice.

18.4 Sales: It is common knowledge that there is a big difference between the market price and the sale price recorded in the registered sale documents of housing plots, houses and flats, since both the buyer and seller are interested in suppressing the price. The task of the Assessing Officer is difficult and the AO should tap the various available sources of information.

The advertisements appearing in the news paper mentioning the market price of the flats is an important piece of evidence. Sometimes, advertisements are placed by brokers and property consultants. Quite often the real estate businessmen themselves advertise the market price of the flat/ houses, through brouchers. Even if the flats/ houses advertised do not belong to the assessee concerned, the data can be used to compare the price disclosed in the books by the assessee. If the advertised flats are situated in the same locality and the quality of construction is similar, the advertised price can be used as a yardstick to measure as to whether the price disclosed is genuine or not.

18.5 NRI Gifts/ Share Capital in New Companies: The Assessing Officer may examine the return of the promoters, their wives, children and other close relatives for the period during which bulk of the flats are sold. Look for instances, where amounts are introduced by way of NRI gifts, agricultural income, loans etc.. The AO should also look for new companies/ firms of the promoters or their family members where fresh capital by share-holders/ partners are introduced. Coordinated investigation of such gifts/ credits etc., along with evidences of suppression of sale price of flats might yield good results.

18.6 Residuary Rights of Builders: The builder retains some rights even after the projects are completed and fully sold out. Such rights include:

i. Right of maintaining the flats/ houses and collecting the charge for the same till a society is formed.

ii. Sale of parking lots.

iii. Unexploited FSI.

iv. Terrace rights including the right to put up hoardings.

v. Right to use unoccupied land which can be leased out for commercial purposes.

vi. Rent from Community Hall when it is leased for purposes like marriages, etc.

The Assessing Officer should see whether the value of these rights has been disclosed in the accounts and in the return. If not, the same should be evaluated and included in the taxable income.

19. VALUATION FOR ESTIMATING COST OF CONSTRUCTION

The building trade is a potential area for generation and deployment of large amounts of black money. Department's record in unearthing this has not been particularly successful. The basic issues on which department's efforts in the cases of builders flounder are, both, lack of technical expertise, and inability to get material information. In addition, procedural problems relating to valuation etc. further reduce the success rate of department's efforts.

20. SURVEYS UNDER SECTION 133A

It is advisable that the AO should visit the project sites, for conducting relevant enquiries and investigations. This would give the Assessing Officer a first-hand knowledge of the size of the project, quality of construction, and the sale price. In cases of major builders, records are kept at the site which would give a true picture of the business. A survey under Section 133A may be conducted in appropriate cases, when the project is about to be completed so that, the evidence for most of the expenditure and receipts can be seen. If the survey is conducted subsequent to the completion of the project, the chances of removal or destruction of records are very high. It would be prudent to conduct such surveys near the end of the accounting year.

The experience shows that such surveys have yielded good results. In one case survey showed that out of the 4 parties from whom the assessee claimed to have purchased bricks, two were sister concerns that never supplied any bricks. The inflation of purchase of bricks was to the extent of several lakh. The fall out of another survey was discovery of many suppliers of materials such as bricks, sand, ruffle who were not assessed to tax although their turnover was substantial. The wages debited in the ledger maintained in the head office was higher than the wages register maintained at the site. The AOs should look for the rough cash book maintained at the head office. It would give the true picture of the receipts and payments.

21. CONCLUSION

Real Estate is an ever green investment option in India and it has always given good returns. It can be a residential or commercial property. Real Estate gives recurring income in the form of rent and appreciation in value in case of re-sale. As it gives good return, so taxation, whether direct or indirect, in real estate sector has always been a very critical issue. In the recent past, changes have been made in the different tax laws to bring various activities, income, charges or fee etc. under the tax regime. Government has also made various kinds of provisions in the recent budgets to curb the generation of black money through real estate transactions. However, there is still scope for further clarity on many issues related to taxation.

As real estate is a vast field and involves various aspects, multiple rules and regulations, suspicious accounting of inventory, revenue recognition, multiple tools to evade taxes and consuming huge unaccounted money, it presents a big challenge to the Assessing Officer. Therefore, conceptual clarity and up-to-date knowledge of the fast changing legal scenario, in this regard, is a prerequisite as comprehensive analysis of such information would enable the application of concepts precisely. In this background, the preceding paras constitute a set of generalized guidelines and the Assessing Officers are also expected to evolve specific check list keeping in mind the facts and circumstances of the case under investigation.

CHAPTER 8

Drugs and Pharmaceuticals

1. INTRODUCTION

The Medicare system in India embraces allopathic, ayurvedic, unani, siddha and homeopathic systems. The drugs and pharmaceutical industry is an essential part of Medicare. Medicines currently manufactured in India cater to all these systems.

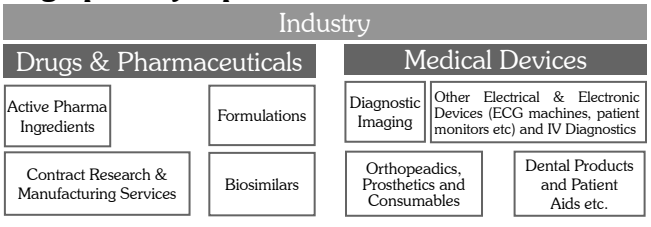
2. INDUSTRY PROFILE

2.1 The Indian pharmaceuticals market is the third-largest in terms of volume and thirteenth-largest in terms of value. It accounts for 20 per cent in volume terms and 1.4 per cent in value terms of the Global Pharmaceutical Industry. It has highest number of USFDA approved plants outside the USA. It's amongst the global leaders in providing quality generics to the world. India is the largest provider of generic drugs globally with the Indian generics accounting for 20 per cent of global exports in terms of volume.

2.2 The Annual turnover of the Indian Pharma Industry during 2015–16 was Rs. 1,85,388 crore. It represented a decline of 7.4% over the corresponding figure for 2014–15 i.e. Rs. 2,00,151 crores. The CAGR for last 5 financial years has been 8.88%. The domestic Pharma market witnessed a slowdown in the recent past owing to the Government's efforts to make medicines affordable. (*Source*: Department of Pharmaceuticals, Annual Report 2016–17).

3. MAJOR SEGMENTS OF PHARMA SECTOR

The major segments of the pharma sector can be graphically represented as follows:



3.1 Active Pharmaceutical Ingredients (APIs): An API is the ingredient in a pharmaceutical drug that is biologically active. India became the third largest global generic API merchant market in 2016, with a 7.2 per cent market share.

3.2 Formulations: A formulation is a mixture or a structure such as a capsule, a pill, tablet, or an emulsion, prepared according to a specific procedure (called a "formula"). Formulations are a very important aspect of creating medicines, since they are essential to ensuring that the active part of the drug is delivered to the correct part of the body, in the right concentration, and at the right rate (not too fast and not too slowly).

3.3 Contract Research and Manufacturing Services (CRAMs): The pharmaceutical market use outsourcing services in the form of contract research organisation and contract manufacturing organisation. In simple terms, the research/ manufacturing is done by engaging third party service providers and not in-house

3.4 Biosimilars: A biosimilar is a highly similar version of an approved biologic, the so-called "reference product". Made from living organisms, biologics are proteins which are often anti-biotics, that interact with body to produce therapeutic outcome.

4. SPECIAL LAWS AND REGULATIONS

4.1 Drugs Price Control Order: The National Pharmaceutical Pricing Authority has to do the work of price fixation. This expert body is given the task of updating the list of drugs under price control each year on the basis of the established criteria/ guideline. Time limits are provided for deciding the applications for price approvals. This body also monitors the prices of decontrolled drugs and formulations and oversee the implementation of the provisions of the Drugs (Price Control) Order. The Government has the power of review.

4.2 Drug Rules and Tax Investigations: Rules 74, 74A, 74B, 78 and 78-A of the Drugs and Cosmetics Rules, 1945 require the manufacturers to show details relating to actual utilisation of raw materials in manufacture and the time-frame for manufacture. These can be useful tools for the AO.

4.3 Records of Raw Materials: The law mandates that records in respect of each raw material shall be maintained indicating the date of receipt, invoice number, name and address of manufacturer/ supplier, batch number, quantity received, pack size, date of manufacture, date of expiry, if any, date of analysis and release/ rejection by quality control, analytical report number, with special remarks, if any, quantity issued, date of issue and the particulars of the name and batch numbers of products for the manufacture of which issued and the proper disposal of the stocks.

4.4 Quality Control: A major objective of the Drugs and Cosmetics Act, 1940 and the Rules made thereunder is to ensure that the drugs manufactured and sold to the ultimate consumer are of the desired quality. The quality control in pharmaceutical industry has the ideological goal of zero risk and zero defect.

Such a strict quality control cannot be carried out without proper documentation. Batch records are a storehouse of information. They contain documents which give the entire history of each and every batch or product item the company has produced and distributed as a part of its business. The records are retained in an orderly manner by the manufacturer for proper retrieval. The batch record contains completed copies of batch formulation order, processing data, fill/ label/ pack order, complete test notes or analytical results of all drugs in process and finished goods analysis, packing data, yield records and managerial accountability. All these records and documents (pertaining to every product lot) are routed to a centralised filing area and placed in an individual batch folder or a docket. Actual practice may vary from manufacturer to manufacturer. Some of the manufacturers have incorporated those practices into their training and Internal Audit Manuals. Rule 78 (c) of Drugs Rule stipulates retention of records of manufacturer and laboratory test reports on each batch of the final product. The rule stipulates laboratory test either in manufacturers laboratory or in any laboratory approved by the licencing authority. The records are required to be retained in case of a substance for which a potency date is fixed for a period of two years from expiry of such date and in case of other substances for five years from the date of non-dated products and for a period of two years from the expiry date when a shelf life is assigned.

4.5 Cost Accounting Records

4.5.1 India is the pioneering country which has introduced statutory cost audit for companies. Rules relating to drugs were promulgated effective from 01/04/1974. The costing records (usually not produced before Assessing Officer) have to be maintained on a continuous basis.

Yet, Cost Audit, unlike financial audit, is not carried out every year. Manufacturers of drugs and formulations are statutorily required to keep records relating to the following:

i. Materials consumption.

ii. Waste materials and their disposal.

iii. Net consumption of solvents like acetone, alcohol, methanol. These are process chemicals and are recovered on the completion of the process. The records should indicate the absorption or loss in the process or solvents used.

iv. Correlation between the consumption of production materials and the batch of production.

v. Power and fuel consumption.

vi. Consumption of brine and chilled water.

vii. Cost of production and distribution of raw water, soft-water demineralized water and compressed air.

viii. Quantity or by-products derived and the basis adopted for their pricing for giving credit to the respective bulk drugs and intermediates.

ix. Wages and salary paid. Necessary records are also maintained in respect of all payments made for the overtime work and the casual labour.

x. Separate records showing the expenses incurred on export of bulk drugs (so that cost of sales within the country and for export can be correctly determined). The export expenses as well as the credits relating to drawbacks, sale of import entitlements etc. are shown in the cost of export statements to arrive at the net cost of exports.

xi. Packing costs for different types and pack sizes.

xii. R&D expenses.

xiii. Transfer price for bulk drugs used for captive consumption. Separate records are maintained showing the quantity of bulk drugs for captive consumption by the formulation division of the company and the quantity sold to outside parties. The quantities transferred to formulations for captive consumption is to be valued at a price not exceeding the price determined under the DPCO. If the formulation in the aforesaid case is exempt from price control, a proper transfer price will have to be adopted by the Assessing Officer for the purpose of Section 80-J deduction for a new industrial undertaking.

xiv. Details of work-in-progress and finished goods stock. These have relevance for the valuation of closing stock in financial statements.

xv. Reconciliation of cost and financial account.

xvi. Records for stock verification. Records of physical stock verification are maintained in respect of all materials including different solvents, raw materials, packing materials, consumable stores, small tools and machinery spares and finished goods stock.

4.5.2 The manufacturer is required to maintain data relating to:

i. Batchwise production.

ii. Standard and actual yields.

iii. Operational efficiency of individual departments.

iv. Solvent losses.

v. Number of fermentation carried out.

vi. Equipment occupancy and usage.

vii. Major repairs and maintenance carried out.

viii. Capital employed separately for the bulk drugs activity.

ix. Fresh investments on fixed assets that have not contributed to the production during the year.

x. The broad effect of underutilisation of capacity on the cost of production of the bulk drugs.

5. SPECIAL PROVISIONS IN INCOME-TAX RELATED TO PHARMA INDUSTRY

Apart from the regular provisions of Income-tax applicable to income from Business & Professions, there are few Sections which are applicable specifically to Pharma companies. A brief about the Pharma related Income-tax provisions are stated below:

5.1 Section 35 of Income-tax Act, 1961

When assessee carries on any scientific research, the specified expenditure incurred by him shall be allowed as a deduction in the following way:

i. **Revenue Expenditure:** If incurred within 3 years immediately preceding the year of commencement of business, it shall be allowed as a deduction in the year of commencement

ii. **Capital Expenditure:** Capital expenditure enumerated therein except land cost incurred by the assessee, is 100% deductible in the year in which it is incurred.

5.2 Section 35(2AB) of Income-tax Act, 1961

200% deduction in relation to Scientific Research (excluding cost of land & building) on in house research & development facility (including clinical drug trial). 200% deduction shall be allowed to such expenditure incurred till FY 2021. 100% deduction will be applicable on such expenditure incurred after FY 2021.

5.3 I.T. Rules, 1962

There are various specific Rules which the AO needs to be aware of. For instance, Rule 6F(3)(ii) of I.T. Rules mandate that a person carrying on medical profession shall maintain daily case register in Form No. 3C and inventory of stock. To cite one case, where the pharma company claimed that samples were distributed free of cost, the alleged recipient doctors denied the same when asked to submit the copies of said registers. Besides, Rule 6, Rule 5C, etc. have relevance to the proceedings, which may be referred to.

6. TAX INVESTIGATIONS

6.1 Manufacturing Capacities, Company Law and Cost Accounting Record Rules

Provisions relating to preparation of annual accounts and particularly the details given in Schedule VI to the Companies Act, 1956, require the companies to furnish, by way of a note to the profit and loss account, detailed quantitative information in respect of each class of goods manufactured as under-(i) licensed capacity, (ii) installed capacity, and (iii) actual production.

6.2 In a case where actual production is less than the installed capacity, the taxpayer's explanation for the shortfall may be obtained and scrutinised with reference to the facts on record. The drugs and pharmaceutical market is a sellers' market in the sense that the entire production is assured of being sold out. Thus, cases where actual production is less than the installed capacity ought to be examined carefully. Shortfall in production with respect to licensed capacities represents underutilization of invested capital-a situation which a prudent business organisation will do its best to avoid. The taxpayer's explanation should be further cross-checked by reference to the records maintained for the purpose of statutory cost audit and the statistical returns and statements furnished by the company under the Cost Accounting Record Rules. The data obtained under the Cost Accounting Record Rules will enable in-depth investigations.

In cases where semi-processed products are also sold by the company, separate details thereof must be furnished by the company. Under the Companies Act and the Industrial Licensing Policy, the items for which the company is holding separate industrial licenses are to be treated as separate classes of goods and the data relating to licensed capacity, installed capacity and actual production must be stated separately

for each such class of goods. However, where a company has more than one industrial license for production of the same item at different places or for expansion of the licensed capacity, the items covered by all such licenses are to be treated as of one class.

If glaring discrepancies come to notice, the Assessing Officer may take recourse to the provisions of Section 142 (2A) of the Income-tax Act and direct a special financial audit of the assessee's accounts in accordance with the prescribed procedure.

6.3 Net Outflow of Foreign Exchange: Under the Company Law, the P&L Account must contain following information relating to net outflow of foreign exchange by way of a note:

i. Value of imports calculated on C.I.F. basis by the company during the financial year in respect of:
   a. raw material.
   b. components and spare parts.
   c. capital goods.

ii. Expenditure in foreign currency during the financial year on account of royalty, know-how, professional, consultation fees, interest and other matters.

iii. Value of all imported raw materials, spare parts and components consumed during the financial year and the value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption.

iv. The amount remitted during the year in foreign currencies on account of dividend with a specific mention of the number of non-resident shareholders, the number of shares held by them on which the dividends were due and the year to which the dividends related;

In certain cases, outflow of foreign exchange may require prior permission of the RBI, for which application has to be made in the prescribed forms. The disclosures made by the assessees in the various applications for permission to the RBI may be of relevance for tax assessments and investigations.

6.4 Formulation activity represents the high payoff sector of the pharmaceutical industry and bulk drugs manufacture give comparatively low profits, due to differing levels of risks. Accordingly, the profits can vary which needs to be kept in mind by the AO.

7. IMPORTANT AREAS OF INVESTIGATION

7.1 Expenditure on Scientific Research: Liberal incentives have been given under Section 35 for promoting expenditure on scientific research. The AO may call for comprehensive details of expenses and verify the correctness of the claims by examining the following in greater details:

i. Details of research projects initiated.

ii. Details of research projects completed.

iii. Detailed self-evaluation of the research activities by the assessee.

iv. Details of remuneration paid to research personnel and their background and experience in research.

v. Details of papers published by or on behalf of the assessee.

vi. Technical specifications and research potential of the plant and machinery installed for research.

vii. Records of clinical and laboratory trials of drugs tested and rejected during the development stage and detailed reasons for rejection of such drugs.

viii. Details of drug Licenses applied for and drug patents taken out in India.

ix. Performance evaluation records of research personnel.

x. Details of foreign travel by research personnel.

7.2 The AO can record statements of personnel employed on research and development, laboratory and clinical trials under Section 131, wherever necessary. On-the-spot inspection of research activities and verification by the Assessing Officer may be done in cases where deviations are observed.

7.3 The Assessing Officer should examine whether capital expenditure on production, testing, quality control etc. which cannot be considered as expenditure on research, is not wrongly claimed under Section 35. Also in some cases, expenditure on research is incurred by one company and the fruits are enjoyed by another in the same group but with a different composition of shareholders.

7.4 In certain cases, there is functional distribution of business activities-one company owns technical know-how, manufacturing is done in factory owned by another and marketing is done by a third company. In such cases, pricing of transactions will assume importance to ascertain whether it is done in such a manner to give more profit to one company at the cost of another, so as to enable one company to claim deduction for backward area benefits, or benefit of carry forward of losses which would otherwise lapse, or to setoff loss incurred in another activity or just to benefit one Section of shareholders at the cost of another.

7.5 The companies incur huge expenditure on gift articles, sales promotion materials, calendars, etc. Hence the expenditure on gift articles provides a convenient mode of booking bogus expenditure. There have been cases where, on detailed investigation, bogus bills for gift articles are found to be issued by a person who is not engaged in such business at all.

7.6 Selling Agencies: The produce of the drugs and pharmaceutical industry is assured of the domestic market as demand almost always outstrips supply. Expenses claimed to have been made on account of payment of commission etc. to selling agents should be carefully scrutinized and evidence of services rendered must be insisted upon.

7.7 Coordination with the Banks: The taxpayers have to furnish information relating to business finances and operations to the banks on several occasions during the year. The banks have now equipped themselves to look into the organisational capabilities to the business unit, technical and economic feasibility of the project, working capital requirements, monthly turnover etc. Details of securities offered, both primary and collateral, have also to be furnished. The borrower unit has to declare the sources of own contribution (margin money in bank parlance). Further, the banks monitor the utilization of bank credit and the financial soundness of business operations every quarter. For this purpose, the borrowers have to furnish quarterly funds flow statements to the lending bank. The bank managers also send stock verification reports to their head office at the time the loan is sanctioned. In their appraisal memorandum, they carry out performance analysis, Balance Sheet analysis, working capital requirements assessment and verify the list of machinery installed. Considerable information of relevance to tax assessments is also furnished to the banks at the time of application for loan. The Assessing Officer may verify with the information on the tax records and ask the taxpayer to explain the discrepancies that may come to light.

7.8 Penalty: The pharmaceutical industry is highly regulated. Any deviations/ slips-ups invite penal action from the regulating agency. The allowability of such penal expenses needs to be examined in-depth on case-to-case basis.

7.9 Utilization of Imported Raw Materials: Sometimes, imported raw materials could be sold outside the books at a premium. If the assessee company is an importer of raw materials, care should be taken to scrutinize the records relating to receipt, issue and consumption of raw materials by the importing company.

7.10 Pollution Control Equipment: Pharmaceutical industry needs to incur substantial expenditure on pollution control. Some of the equipment for pollution control are eligible for depreciation at the rate of 100%. With

reference to such claims it should be examined if the equipment are used for more than 180 days, otherwise, the depreciation should be allowed only @ 50%. Further, only equipment of specified description are eligible for 100% depreciation. It should be verified that equipment in respect of which depreciation is claimed @ 100% fall strictly within the description of assets eligible for such depreciation.

7.11 Return of Goods: The pharmaceutical products have limited shelf life. Frequently the pharmaceutical products remain unsold with the traders. There is a practice according to which the traders are entitled to return such unsold stocks, or stocks which are damaged to the manufacturer and get credit for value thereof.

7.12 Verification of Consumption: The compositions of pharmaceutical product is predetermined and is printed on the products. This facilitates verification of quantity consumed with reference to production. The pharmaceutical companies are required to maintain detailed record of materials consumed, along with source thereof, process done on each material etc. These are known as 'batch records'. These can be useful in verification of consumption/ production etc.

7.13 Information on Packing: The packing of pharmaceutical product is required to display maximum retail price, batch number, month and year of manufacturing and month and year of expiry and ingredients. This information may become useful for assessment purposes.

7.14 Deductions under Chapter VI-A: Most of the Companies engaged in the manufacturing of drugs and pharmaceuticals claim various deductions under Sections 80-IC, 80JJA etc. of the Income-tax Act. A close scrutiny of the deductions claimed by the assessee encompassing (i) Fulfilment of all conditions, (ii) location in specified/ notified area, (iii) allocation of expenses in a fair and reasonable manner, etc. would be required. In some cases, it has been observed that the assessee has high profits in Section 80-IC units while the profits are low in non-80-IC units and there are inter-unit transfers. It has been further observed that the transferred goods are not priced at market prices and abnormally high deductions are claimed under Section 80-IC. All such cases should be verified by the AO with a thorough analysis of facts and Sub-section 10 of the Section 80-IA read with Sub-section 7 of Section 80-IC should be invoked in appropriate cases.

7.15 In the past, companies were required to deposit excess profits earned into Drug Price Equalization Account (DPEA). However, it was noticed that many assessees were claiming such pay-outs as deductions under Income-tax Act even while challenging the orders passed by the regulatory authority to deposit into DPEA. The allowability of such claims needs to be looked into. Any contingent liability claimed as deduction should be scrutinized carefully.

7.16 The drugs are distributed across India through a web of wholesalers, distributors and retailers. On-line pharmacy is also gaining root now. Besides, large chains of pharmacy stores have emerged over the last few years. Most of the participants of the distribution set-up show low profits. The AO needs to check on the gross profit ratio and also whether the entire turnover is considered in the return of income.

7.17 Other Aspects

a. **Royalty:** The companies could evade tax payments by paying greater amount of royalties to resident as well as non-resident group entities in order to recognise it as an expense in a more profitable company or the company which is exposed to a higher tax structure so as to reduce the tax exposure on a group level.

b. **Over-invoicing of Raw Materials:** The companies could avail raw materials at a higher price from the known suppliers so as to reflect a higher amount of expenditure in the *P&L* account to reduce the profitability thereby paying less taxes.

c. **Over-invoicing of Equipments**: The companies could procure equipments at

a higher price from the known vendors so that the company could capitalise the cost and claim in the *P&L* a higher amount of depreciation on them which is a tax deductible expenditure to reduce the profitability thereby paying less taxes.

d. **Under-invoicing of Revenues:** The companies could sell its goods or merchandises to its stockists, distributors, etc at a lower price in order to recognise less revenues thereby paying less taxes.

e. **"Freebies" to Medical Practitioners:** Pharmaceutical companies incur large expenditure on samples. The companies could claim a deduction under Section 37 (1) of the Income-tax Act by showing actually sold goods as freebies to various medical practitioners instead of sales. As per explanation to Section 37(1) of the Act, any expenditure for a purpose which is an offence or which is prohibited by law is not an allowable business expense. MCI vide Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 provided that medical practitioners should prescribe generic drugs as far as possible. It inter-alia prohibited them to solicit or receive any commission, gifts etc. for any approval or recommendation, endorsement of any medicine or drug for advertisement purpose or for referring or recommending any patient any medical, surgical or other treatment. Vide amendment dated 10 December 2009, Pharmaceutical companies were specifically prohibited to give any consideration in the nature of gifts, travel facilities, hospitality, cash or monetary grants etc. CBDT issued a circular vide No. 5/2012 (F. No. 225/142/2012-ITA.II], dated 01 Aug 2012 and clarified that such expenses would not be allowable.

f. **Manipulation of Closing Stock/ Inventory:** The companies can manipulate the valuations of the closing stock so as to reflect it at an amount lower than the actual amount. This in turn would bring down the gross profit figure and also net profit figure thereby reducing the tax liability.

g. **Research & Development Expenses:** The company can recognise its non-research expenses as Research expenses in an attempt to utilise the weighted deductions available under Section 35.

h. **Spurious Drugs:** The company can manufacture regulated drugs above their manufacturing limits or manufacture drugs counterfeiting a competitors' drug. The chances of reporting of revenues in such cases are very rare and hence, special attention is required in these cases.

i. **Siphoning of Money:** The company can siphon off money from the company by labelling it as capital expenditure, research expenses, etc.

j. **Camouflaging of Capital Expenditure as Revenue Expenditure:** In certain cases, the Capital Expenditure is claimed as Revenue Expenditure to reduce the taxable profits of current year.

k. **Claim of Depreciation of Patents of Different Entity:** The depreciation claimed in respect of patents owned by different entities are not allowed in the hands of assessee.

8. SIGNIFICANT ISSUES ENUMERATED IN THE CAG REPORT

The Comptroller and Auditor General of India, had conducted a Performance Audit on Assessment of Assessees in Pharmaceutical Sector for the year ended March 31, 2014 and the report was submitted to Parliament vide Report No. 5 of 2015. The Public Accounts Committee (2018–19) presented the 136th Report based on the Comptroller and Auditor General Report No. 5 of 2015 related to Ministry of Finance (Department of Revenue). Some of the important highlights of the Report observing

the shortcomings of the Department with specific reference to pharmaceuticals sector are placed below:

a. The weighted deduction on R&D under Section 35 (2AB) of the Act was allowed before receipt of approval from DSIR who is the approving authority.

b. AO allowed weighted deduction on R&D expenses under Section 35(2AB) of the Act without verifying the details of expenditure approved by Department of Scientific and Industrial Research in Form 3CL/3CM.

c. The Department of Scientific & Industrial Research (DSIR) guidelines, for approval of claim of weighted deduction under Section 35(2AB) of the Act delineates various conditions for eligibility of capital and revenue expenses on R&D. Any expense not satisfying the conditions mentioned therein are to be excluded before computing weighted deduction on R&D expenses. In certain cases, the R&D expenditure was allowed although the conditions mentioned in DSIR guidelines were not satisfied.

d. TDS deduction under Section 194C deduction was not made in respect of payments to contract manufacturers.

e. In respect of units where deduction under Section 80-IC was claimed, certain firms artificially increased the profit and took undue benefit of deductions under Section 80-IC by not providing for salary and interest to partners even though the same was provided in the Partnership Deed. The AO did not examine such cases by applying Sub-section 10 of the Section 80-IA read with Sub-section 7 of Section 80-IC.

f. Cross-verification of turnover declared in Income-tax Return with Excise Returns (now as per GST provisions)

g. Inadmissible expenditure such as gifts, travel facilities, hospitality, cash or monetary grant were allowed although they could not have been allowed under Section 37.

h. AOs allowed the expenditure on sales promotion which included prohibited expenses on freebies.

i. Physicians samples given free of cost to medical practitioners was not disallowed. As the physicians samples are given free to medical practitioners and it influences the decision of medical practitioners in prescribing medicines in favour of branded medicines instead of generic ones, hence it was in the nature of offence of law and therefore was disallowable.

j. Non-disallowance of expenditure towards penalty by National Pharmaceuticals Pricing Authority.

k. Research & Development and common expenditure are required to be allocated to the beneficiary units either on actual basis or on the basis of their sales turnover ratios. AOs allowed the same without ascertaining the proper allocation. In one case, the assessee used ratio between manufactured sales of individual unit and gross sales (inclusive of turnover of traded goods) of all the units. As the benefit of R&D was used only by manufactured goods and not the traded goods, it was opined that turnover of traded sales was required to be excluded from working of ratio.

l. AOs allowed concessions/ deductions/ rebate/ relief to assessees without verifying the conditions specified in the provisions of the Act.

m. AOs allowed setting off/ carry forward of depreciation/ business loss/ capital loss in contravention of the provisions of the Act.

n. International transactions were not furnished in Form 3CEB.

9. SUCCESS STORIES

There have been several success stories with respect to unearthing tax evasion/ enforcing tax laws in the drugs and pharmaceuticals sectors. Three such cases are shared here for the benefit of AOs.

9.1 Assessment: A perusal of "selling and distribution expenses" showed an expenditure of Rs.7.53 crores as "instruments held for distribution". It was seen that medical instruments which had a life span of several years had been kept at the hospitals for demonstration purposes and for aiding the doctors in surgeries. It was further seen that the assessee had distributed such assets in earlier years also but treated it as capital expenditure and claimed depreciation. However, the policy was changed in current year and entire cost of assets were claimed as revenue expenditure. In view of the detailed questioning by the AO, the assessee admitted that its claim was not tenable and paid Rs. 3.23 crores as taxes. No appeal was filed. (*Source*: Let us Share Vol. III-2010; pg 47]

9.2 Survey: Analysis of expenditure was undertaken in the case of a pharma company which was reporting huge losses from non-EOU units and huge profits from EOU units. Survey action under Section 133A was undertaken. It was found that (i) entire R&D expenses were debited to non-EOU units; (ii) inter-unit transfer of materials from non-EOU to EOU units was done at lower than cost price. In view of the meticulous evidences gathered by the survey team, the assessee filed before ITSC and paid a sum of Rs. 95 crores as additional taxes. (*Source*: Let us Share Vol. IV-2011; pp. 213]

9.3 Search: The assessee was engaged in the pharmaceuticals business with exports to the Ukraine, Cyprus, and Russia. In the course of search and seizure operation, the marketing/ business promotion expenses were found to be unusually high at 50 per cent of the turnover. Such expenses were stated to be made to the companies in the Ukraine, Cyprus, and the UK. It was found that the Cyprus and Ukraine based companies had previously been owned by the director and some employees of the assessee company were linked with them. The seals and stamps of these companies were found on the premises of assessee company during search. Details of huge investments in the name of director and his family members were also found. FT&TR enquiries were made from the UK, Germany, Switzerland, Cyprus, and the Ukraine. Enquiries revealed among others, (i) one of the companies was not registered at the address mentioned in the documents seized (ii) the transactions were only on paper, (iii) the director and his wife used to be directors of certain companies, (iv) no expenses for office premises, and wages/ salaries were incurred by these concerns, (v) the Balance Sheets of these companies did not have any property, (vi) the registered office address was the residential address of the accountant. This supported the conclusion of these companies being paper companies and funds were siphoned off. A detailed statement of the taxpayer was recorded and he failed to explain the transactions. Based on the EOI enquiries and documents seized in the course of action under Section 132, the taxpayer was denied the bogus claim of expenses of around Rs. 150 crores. (*Source*: White Paper on Black Money, May 2012; pg. 45]

10. CONCLUSION

The preceding paras constitute a set of generalized guidelines and in this background it is expected that the Assessing Officer will evolve his own checklist suitable to the facts and circumstances of the case under investigation. The various aspects of investigation highlighted elsewhere in this Manual will also be of considerable relevance for the Assessing Officer.

CHAPTER

9

Petrochemicals and Chemical Industry

1. INTRODUCTION

1.1 'Chemical and Petrochemical' sector is one of the most diversified of all industrial sectors covering thousands of commercial products. The Indian chemicals industry with a market size of USD 290 billion in 2017 is the 'seventh' largest producer of chemicals worldwide and the 'third' largest producer in Asia after China and Japan.

1.2 The industry consists of various segments such as chemicals, petro-chemicals, agro-chemicals, specialty chemicals, colorant chemicals, bio-pharma, bio-agri, and bio-industrial products. Chemicals can be broadly divided into the following categories:

i. **Basic Chemicals:** Chemicals such as organic and inorganic chemicals, bulk petrochemicals, other chemical intermediates, plastic resins, synthetic rubber, man-made fibers, dyes and pigments, printing inks are basic chemicals. These are also known as commodity chemicals.

ii. **Specialty Chemicals:** Specialty Chemicals, also known as performance chemicals, are low-volume but high-value compounds. These chemicals are derived from basic chemicals and are sold on the basis of their functions. For example, paint, adhesives, electronic chemicals, water management chemicals, oilfield chemicals, flavors and fragrances, rubber additives, paper additives, industrial cleaners and fine chemicals. Sealants, coatings, catalysts come under this category.

iii. **Agro-Chemicals:** Chemicals which essentially are meant for protecting agriculture crops against insects and pests are covered under this sub-group.

2. PETROCHEMICALS

The Petrochemicals Industry is broadly defined as that industrial activity which uses petroleum or natural gas as a source of raw materials and whose products are neither fuels nor fertilizer. The petrochemical industry begins with oil refineries or extracting plants built to remove

ethane and higher hydrocarbons from natural gas streams; and sometimes methane itself is used as a source material or feedstock. Both private and public sector ownership thrives in most phases of petrochemical manufacture.

3. MAJOR PRODUCTS AND THEIR CLASSIFICATION

3.1 The original raw material of the industry is crude oil. Ready and easy availability of crude oil is pre-requisite of the establishment of petrochemical industry. The major products and their classifications are as under:

i. a. Naphtha or gas cracker plants produce ethylene, propylene etc.

b. Aromatic complexes to produce: Benzene, Toluene and Xylene, etc.

ii. a. Polymers, styrene, etc.

b. Synthetic fiber

c. Elastomers like butyl rubber, SBR, PBR, etc.

d. Surfactant intermediates

e. Other petrochemicals like solvents etc.

iii. Synthetic fibers.

iv. Polymers & plastic materials etc.

The process of generation of feed-stocks (fuel to machine) can be understood as per process flowchart below:

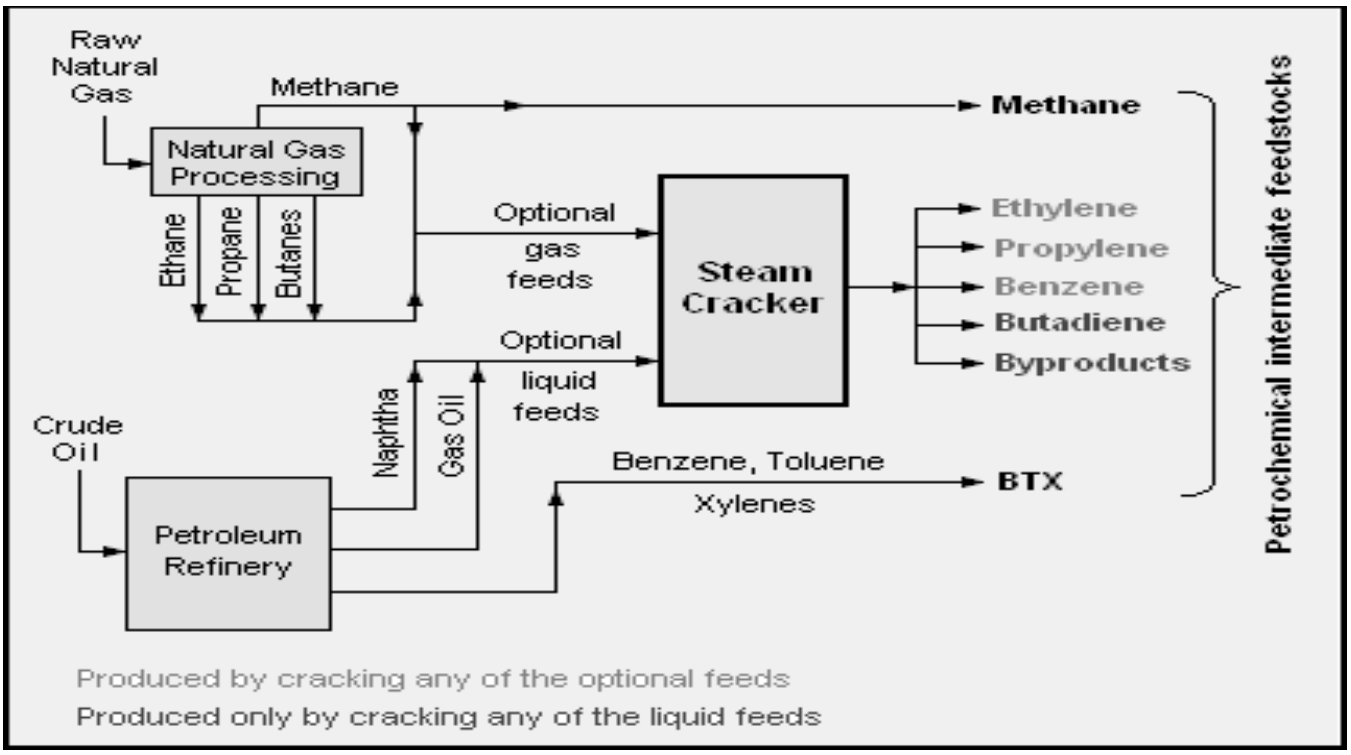


Fig. 1

3.2 Chemical plants produce olefins by steam cracking of natural gas or other hydrocarbon feedstock, like ethane and propane. Aromatics are produced by catalytic reforming of naphtha. Olefins and aromatics are the building-blocks for a wide range of materials such as solvents, detergents, and adhesives. Olefins are the basis for polymers and oligomers used in plastics, resins, fibers, elastomers, lubricants, and gels.

4. MARKET STRUCTURE

4.1 Gujarat leads in production of chemicals and petrochemicals, followed by Maharashtra, Himachal Pradesh, Uttarakhand, Uttar Pradesh, Tamil Nadu and Karnataka.

4.2 Most of the output of the Indian petrochemical sector constitutes polymers, and in the last few years, the growth rate of these industries has been between 16% to 18% per annum. These petrochemical objects are sold through stockists, C & F channels, and distributors. The companies directly meet the large volume sale. Prices are determined by international pricing and are very volatile in nature. Two major factors affecting the prices are price of crude oil and foreign exchange rate of Rupee vis-à-vis US Dollar.

5. PCPIRS

Government of India has approved four Petroleum, Chemical and Petrochemical Investment Regions (PCPIRs) in the States of Andhra Pradesh (Vishakhapatnam),Gujarat (Dahej), Odisha (Paradeep) and Tamil Nadu (Cuddalore and Nagapattinam) to promote investment and industrial development in these Sectors. The PCPIRs were conceptualized in a cluster approach to promote the Petroleum, Chemical and Petrochemical sectors in an integrated and environmental friendly manner on a large scale. The State Government notifies a Nodal Department or Agency for co-ordinating the linkages.

6. TRADE PRACTICES

6.1 In Indian Petrochemical Industry, major manufacturers are Reliance, NOCIL, GAIL, IOCL Haldia Petrochemicals etc. Consumers of Intermediate and final products are mostly medium and small scale industrial units situated all over India. The petrochemical industry is a knowledge intensive as well as capital intensive industry.

6.2 Most of the petroleum products are being taxed @ 18 per cent under the chapter of 'GST'. Some other petroleum products are taxed at a lower rate of 5 per cent. These are: (i) Kerosene (sold through the public distribution system) (ii) Liquefied propane and butane mixture, liquefied propane, liquefied butane and liquefied petroleum gas for supply to household domestic consumers or to non-domestic exempted category customers by the Indian Oil Corporation, Hindustan Petroleum Corporation or Bharat Petroleum Corporation. At present, crude oil, natural gas, ATF, diesel and petrol are not in the purview of 'GST'.

7. OTHER LAWS AND MAINTENANCE OF RECORDS

7.1 The Petrochemicals and Chemicals Industry is a highly regulated Industry. Apart from the laws generally applicable to manufacturers and traders such as GST Act, Labour Law, Customs Act, Electricity Act, Factories Act etc., there are many environment related, hazards and safety related and waste disposal related laws applicable to this industry.

The following rules and regulations are to be followed by the industries:

Table 1

Sr. No.	Legislation
1	Water (Prevention & Control of Pollution) Act 1974 and Water (Prevention & Control of Pollution) rules
2	Water (Prevention & Control of Pollution) Cess Act 1977 and Water (Prevention & Control of Pollution) Cess rules 1978, Water (Prevention & Control of Pollution) Cess (Amendment) Act 2003
3	Air (Prevention & Control of Pollution) Act 1981 and Air (Prevention & Control of Pollution) rules 1982
4	Noise Pollution (Regulation and Control) Rules, 2000 amended till date
5	Environment (Protection) second amendment rules, 2002 specifying Noise limits for Diesel generators (DG Set)
6	Environment Protection Act (EP ACT) 1986 and Hazardous Wastes (Management & Handling) Rules 1989, 2000 & 2003
7	Hazardous waste (Management, Handling & Transboundry Movement) Rules 2008
8	Hazardous Wastes (Management & Handling) Rules 1989, 2000 & 2003, 2008
9	Batteries (Management & Handling) Rules 2000, 2010
10	Manufacture, Storage and import of Hazardous Chemicals rules 1989, amended 2000
11	The Static and Mobile Pressure Vessels (Unfired) Rules 1981 and amended
12	The Petroleum Act, 1934 and The Petroleum rules 1976
13	The Indian Factories Act 1948
14	The Indian Boilers Act 1923
15	The Chemical Accidents (Emergency, Planning, Preparedness and Response) Rules 1996
16	Environment Protection Act 1986 and amended
17	Environment Protection Rules, 1992 & 1993–Environmental statement
18	Ozone Depleting Substances (Management & Handling) Rules, 1998.
19	Public Liability Act, 1991
20	Electricity Act 2003, Electricity Rules 2005
21	Applicable Municipal Corporation regulations for Waste
22	E-waste (Management and Handling) Rules 2011
23	Bio-medical Wastes (Management and Handling) Rules 1998
24	Explosive Substances Act

7.2 All the manufacturers are required to get registered themselves, with the appropriate authorities for compliance with various laws. Generally, these Acts/ Rules require the industrial units to file regular monthly, quarterly or annual returns relevant for that particular regulation. The data in such periodic returns can be a good source for the Assessing Officers to examine the veracity of the accounts of any industry. Investigating authorities and AOs may like to liaise with Ministry of Environment & Forests under Environment Protection Act, 1986, Chief Controller of Imports & Exports under Import & Export Control Act, 1947, Pollution

Control Boards, Chief Inspector of Factories, Chief Inspector of Dock-Safety, Chief Inspector of Mines, Chief Controller of Explosives, Directorate of Explosive Safety or even Atomic Energy Regulatory Board.

8. DYES, COLOURS AND CHEMICALS

8.1 Dyes may be defined as intensely colored substances, which when applied to a substrate, impart color to the substrate by a process which, at least temporarily destroys any crystal structure of the colored substances. The basic raw materials used for the manufacture of dyestuffs are benzene, toluene, xylene and naphthalene (BTXN).

8.2 Dyes are applied to textile fibers by two distinct processes-dyeing and printing, of which, the former is much more extensively used. In dyeing process, the fiber absorbs the dye from an aqueous solution or dispersion, and is more or less uniformly colored. The solution of the dye is the dye liquor or dye bath, and as the dyeing proceeds the concentration of the dye increases in the fiber and decreases in the bath. Ultimately under favourable conditions there is practically no dye in the dye bath, which is then said to be exhausted. The uniformity of dyeing (level dyeing) depends on the absorptive power of the fiber, the nature of the dye and the conditions of dyeing. Apart from their application to textiles, dyestuffs are used for many purposes, divisible into classes. The first is the coloration of various materials other than textiles, such as paper, leather, oils soap, plastics, paints, varnishes, lacquers, printing inks, foods, drugs, and cosmetics. Dyeing anodized aluminum is a recent application. Uses of dyes as indicators, staining agents in bacteriological and histological work, and sensitizers of films and plates for photography are also based on the tinctorial or light-absorption characteristics of dyes. The second includes noncoloring purposes, depending on the incidental properties of dyes, such as antibacterial and chemotherapeutic activity.

8.3 Oil and Wax Soluble Dyes (e.g. Indulines and Nigrosines) are useful in the manufacture of shoe and furniture polishes, carbon papers, crayons, candles, sealing wax, lubricating oils, and ink for ball-point pens. Volatile organic pigments are employed in war time for the production of colored smokes for signals. With the object of rendering targets undetectable by infrared photography, dispersions of the phthalocyanines and of Pigment Green (iron complex of 1-nitroso-2-naphthol) have been used. Various types of dyes are extensively used in photography; as *Indicators and analytical reagents; asfood colors; and for Medicinal uses.*

9. PESTICIDE AND INTERMEDIATES

9.1 'Agrochemicals' are the substances manufactured through chemical or biochemical processes containing the active ingredient in a definite concentration along with other materials which improve its performance and increase safety. For application, these are diluted with water in recommended doses and applied on seeds, soil, irrigation water & crops to prevent the damages from pests.

Classification

There are broadly 5 categories of crop protection products:

i. **Insecticides:** Manage the pest population below the economic threshold level.

ii. **Fungicides:** Prevent the economic damage due to fungal attack on crops.

iii. **Herbicides:** Prevent/ inhibit/ destroy the growth of unwanted plants in a crop/ field.

iv. **Bio Pesticides:** These are derived from natural substances like plants, animals, bacteria & certain minerals. These are non-toxic & environmental friendly.

v. **Plant growth regulators.**

9.2 The following companies are involved in the manufacturing of pesticides such as Rallis, FMC, Dupont, Syngenta, Bayer and Nihon Nohayaku. In addition, UPL has had a series of small acquisitions globally to enter new geographies and gain product expertise. But, at the same time a larger market of pesticides is manufactured by small and medium scale industries.

9.3 The yield can be obtained from the Standard Input Output Norms (SION) number, description, quantity is described in Sub-section (1) of Section 25 of the Customs Act, 1962 (52 of 1962), the Central Government. This is available as book called Foreign Trade Policy, Input Output Norms.

10. CHEMICAL FERTILIZERS

Balanced use of various fertilizers is necessary to preserve soil health, as any excess use of any one of the Fertilizer only will damage soil fertility in long run.Chemical fertilizers are Nitrogen or Phosphorous or urea-based. Urea and Diammonium Phosphate (DAP), and Nitrogen–Phosphate–Potassium (NPK) are most commonly used chemical fertilizers. IFFCO, KRIBHCO, National Fertilizers Ltd., are the main producers of chemical fertilizers in the country. Nitrogen, Phosphorous and potassium are primary nutrients for living plants. Here in the chemical fertilizer so produced, Phosphoric Acid is the source for Phosphorous, Ammonia and urea are the sources of nitrogen, Muriate of Potash is the source for potassium and Filler is added to balance the fertilizer composition.

Tax Investigation

10.1 Verification of Loss During Transportation: Assessee purchasing liquid petro chemicals many times claim losses during transportation. However, universally, such losses are acceptable upto 0.5% only or as per some written agreement with the transporters. Any losses during transportation in excess of this should be verified in depth.

10.2 Verification of Loss on Account of Evaporation: Where assessee claims extraordinary losses on account of evaporation, the Assessing Officer should verify flash point of the product involved and in case of a low flash point (which would increase evaporation), whether the assessee has received a certificate from Department of Explosives. The Assessing Officer should also find out the location of the storage tanks, i.e. whether such storage tank are located above ground or below ground which affects the evaporation rate.

10.3 Verification of Reasons of Low G.P. Ratio: Normally it is found that petrochemical manufacturers declare low GP ratios by claiming handling losses, process losses due to power failures, and production of bye-products etc. Therefore, specific enquiries are required to be made to understand the stepwise manufacturing process as well as use of various catalysts and production of bye-products at each stage of the manufacturing process.

10.4 Verification of Process Loss on Account of Power Stoppage: If power failures are shown as reason for major losses, the Assessing Officer should verify whether the assessee has diesel generator sets available, and whether the assessee has a continuous process for which the Electricity Boards generally provide separate power lines or informs in advance about the power stoppage. This would reduce the possibility of the assessee's alleged process losses due to power failures.

10.5 Verification of Reports of PCB to Examine High Processing Loss: Further, all petrochemical manufacturers have to register with the Pollution Control Boards (PCBs) due

to the hazardous nature of their products. Thus, losses if any, which occur during processing, are likely to be reflected in the effluents discharged by the assessee during the periodical tests carried out by the PCB. Hence, the reports of the PCB can be a major source for cross verifications by the Assessing Officer.

10.6 Verification from other Government Agencies: The manufacturers are required to file declarations with the (i) Central Excise Department, (ii) the Pollution Control Board (PCB) and (iii) the Factories Inspectorate, giving full details regarding products to be manufactured, manufacturing process, chemical formulas, raw materials to be used, classification of the goods, bye products, etc. This information can be cross-verified by the Assessing Officer with the claims made in the return of income.

10.7 Verification of Yield Ratio by Comparing with Past Years Ratio: Where the assessee shows any major fluctuations in yields from earlier years without any change in source of raw materials or the manufacturing process, the claim would require deep study as to whether reasons are genuine or not. Such verification can be done by verifying the production register, consumption register and stock register maintained as required by the Central Excise Department.

10.8 Cross Verification from CGST Department: Often, the assessee also try to sell the material in open market without processing but still claim Modvat benefits from the Central Excise Department. This would again require cross-verification with the sales to find out the genuineness of the assessee's claim of value addition and process losses, if any.

10.9 Verification of Use of Imported Raw Material: Where the assessee bring imported raw material, the bill of entry filed with the Customs Department should be verified as to the end use of such material. A cross-verification with end-users of assessee's product should also be carried out to see whether assessee has actually utilised the imported material in his manufacturing process or the imported material has been sold out in open market.

10.10 Verification of Claim of Expenses under Various Heads: Since purchases are mostly from the established players in the market, these are easily cross-verifiable. Since regular credit facilities are generally available, cash purchases require close examination. Heavy expenses on account of other consumable, labour, power and fuel consumption also require to be verified as likely heads under which profits may be suppressed by the assessee.

10.11 Verification of Claim of Losses on Account of Wastage and Scrap: Manufacturers of items from polymers such as PVC etc. claim losses on account of wastage and scrap. In such cases, the Assessing Officer should verify whether the polymer concerned is a thermoplastic or a thermoset polymer. Thermoplastics are recyclable and even their scrap has a good market value. The Assessing Officer should also look into valuation of the finished goods, work-in-progress and especially the bye-products through cross-verification with the end-users of these bye-products. Often, a by-product which the assessee claims as of negligible value may fetch good price, if the end-user is having major utilization of the same. In general, there is a likelihood of 'suppression' of the sale value of such by-product. The Assessing Officer may verify from other manufacturers as to whether the sale value shown for such bye-product is comparable to the value declared by the assessee. Also, the stand taken by the Excise authorities in respect of classification of such bye-product should also be cross-verified from the Central Excise Department.

10.12 Valuation of Work-in-Progress: The Assessing Officer should also look into valuation of the work-in-progress by ascertaining the different stages of manufacture, and the value added at each stage of manufacturing process.

10.13 Verification of Job Work Related Documents: Very often, the business is carried on by getting certain jobs undertaken through third parties on job work basis. These parties could be the other concerns of the assessee's group, or third parties. As per the Excise Rules the goods have to be dispatched and brought back only through requisite excise challans. Therefore, the lot wise verification of dispatch and receipt of material needs to be closely scrutinized. Also the rates of job work payments made in respect of transactions with group concerns should be minutely scrutinized and compared with rates prevailing in the particular market.

10.14 Verification of Claim of Various Deductions: Manufacturers often claim benefits in respect of new units established in underdeveloped areas or benefits in respect of small scale units. The Assessing Officer should verify whether actual production activity is carried out by the assessee at the unit based in the backward area. It may be that the assessee carries out actual production at its unit in developed area unit not eligible for such incentives and shows the production as from the new unit eligible for tax incentive. The Assessing Officer can also verify the genuineness of such claims by cross-verifying transportation bills, etc., in respect of raw material and finished goods, octroi and local taxes charged on such material on movement beyond local limits etc. In respect of manufacturers of plastic goods, the Assessing Officer should verify as to whether the product is an item included in Schedule-11 of the Income-tax Act and if so, whether the assessee is registered with the state government as a small scale unit in order to be eligible for tax incentives under Section 80-HH, 80-I, 80-IA, etc.

10.15 Verification of Stock Transfer with Documents: Similarly, the assessee also claims to have transferred its stock from one of its manufacturing location to another and may claim loss during transit or might not even show sale out of such stock transfer. The Assessing Officer should verify the stock transfer with respective stock transfer challan and reconcile the stock with closing stock and sales.

10.16 Utilization of Information with other Government Agencies: The Assessing Officers may also use the Standard Input Output Norms published by the DGFT which has a category of Chemicals and Allied Products. However, the AO should keep in mind that many factors affect the yield. Efforts should be made to find out the exact and specific process being followed by a manufacturer and the relevant yield be found out for the specific products and procedures. Generally, the suppliers of Plant and Machinery also publish standard yield, Input Output norms and other ratios. Usually production of by-products and generation of wastage is an area which should be carefully analyzed by the AOs. Mostly, the simple Input Output equation should confirm for all processes and products. This simplified equation is Raw Material + Catalyst = Product+ By-products + Effluent+ Process Losses + Wastage. Process flow charts are also available and may be used by the Assessing Officer (s).

10.17 Cross Verification of Various Statements Filed to Different Authorities: All the manufacturers are required to register themselves with the appropriate authorities for compliance with various laws. Generally these Acts/ Rules require the industrial units to file regular monthly, quarterly or annual returns relevant for that particular regulation. The data in such periodic returns can be a good source for the Assessing Officers to examine the veracity of the accounts of any industry.

10.18 The yield can be obtained from the Standard Input Output Norms (SION) number, description, quantity is described in Sub-section (1) of Section 25 of the Customs Act, 1962 (52 of 1962), the Central Government. This is available as book called Foreign Trade Policy, Input Output Norms.

10.19 Verification of Suppression of Yield: In the field of chemical business the tax evasion can be easily done by suppressing the yield of the final product and by means of unaccounted sale/ purchases. The manufacturing process of any chemicals is made up of complex chemical reaction which consists of catalysts, raw materials, reagents and final product. Only technical person can understand the veracity of yield. However, various market indicators and other manuals can help us to detect the evasion.

10.20 The yield although fixed for any chemical reaction but it can be disguised by some alternative reaction. Therefore, on the basis of generalized yield, one cannot easily detect the suppression of yield. We have to understand the industry specific and product specific yield to detect any evasion. There were instances of tax evasion in the field of manufacturer of Pesticides. Cases of keeping parallel books of accounts and undisclosed bank accounts to park unaccounted receipts have been observed in field. Likewise many a time, the dye industries are also suppressing the yields as the main consumption is in Fabric Industries which is again prone for tax evasion. One more indicator to detect the tax evasion in chemical industries is the tax rate in GST. Many raw materials are tax free or on nominal tax rate, this gives the tax evader a space to evade the taxes. Instances have been found where unscrupulous businesses arranged the urea meant for farmers or co-operative societies and used it in the chemical process. But, the purchase of such urea cannot be shown in the books; hence bills of other items are sometimes taken to show it as purchase. The tax evasion can also be detected by verifying the use of items regulated by the government. Some chemicals like molasses, cyanides etc. are regulated one. For example, the molasses are mixed in fixed percentage to make cattle feed. It works as a binding agent hence the ratio of use cannot be altered. Some reverse calculation will give the suppression of yield/ sales. Further, the by-product details of any production also give the clue of suppression of yield. In the production of potassium nitrate the by product is sodium chloride (salt) and by verifying the quantity of salt the yield can easily be detected. Therefore, the yield can be determined after careful analysis of entire production flow chart and on the basis of below mentioned information available at various places.

11. WE GET THE YIELD FROM THE FOLLOWING SOURCES

a. The Standard Input Output Norms (in short SION) number, description, quantity is described in Sub-section (1) of Section 25 of the Customs Act, 1962 (52 of 1962), the Central Government,

b. Central insecticide board and registration committee.

c. Department of chemical and petro chemical website.

d. Standard production processes and yield charts by reputed manufacturers of Plant and Machinery.

11.1 Some Tax Evasion Techniques

Some of the tax evasion techniques unearthed are as under:

a. Mixing of RBD palmolein oil in the edible oil because its rate is much lower than other edible oils. The purchase of RBD palmolein oil cannot be shown either the output itself is sold out of books or bogus bills of purchase of regular edible oil are obtained.

b. In the processes of making liquor, the concentration level of alcohol is fixed as per the product. The rest of liquid mixed is de-mineralized water. This is some sort of processed water. The production unit is maintaining the day to today records of de-mineralized water. The reverse calculation gives the true yield of Liquor.

c. The pesticides are mainly sold in liquid form and the effectiveness of it cannot be detected as the end users are unaware farmers. The entire chain from manufacturer, stockist, and dealers are making profit on sale of the products. They are frequently changing its product name and categorization to evade the Central Excise duties.

11.2 Case Study-1

A chemical company was involved in producing potassium nitrate, whose raw material is sodium acetate and the bye product is salt. After analyzing the chemical reaction for producing potassium nitrate, the quantity of its bye product is easily ascertainable. Therefore, the quantitative detail of salt was called for but the manufacturer did not produce the details. Further it was noted that there was an abnormal increase in the purchase of power and fuel as the sodium acetate solution was purchased at 1776.81 MT during the year as against 96.05 MT in the immediately preceding assessment year. Further, the fuel cost had increased from Rs. 14.66 lakhs in the previous year to Rs. 38.33 lakhs during the relevant year. The turnover of the assessee had not increased during the relevant period. During the appellate proceeding before ITAT, the assessee pleaded that with a new manufacturing process it was able to have a net saving of Rs.18.38 lakhs during the relevant period. However, the Hon'ble ITAT did not find any merit in this argument and held that *"for the simple reason that the savings, if any made in the manufacturing process, should have been reflected in the overall GP rate of the assessee. The gross profit rate during the relevant period was 26.28% as compared to the GP rate of immediately preceding Asstt.Year 2006–07 at 32.03%. Accordingly, the appeal of assessee was dismissed".*

11.3 Case Study-2

The assessee was involved in manufacturing of Cattle feeds. The cattle feed was manufactured by mixing Haller Rice Bran & Rice Bran Cutting with molasses. *The Molasses is a regulated item as per State Excise Act and therefore its quantity cannot be managed. Further, the mixing of Haller Rice Bran & Rice Bran Cutting with molasses is to be in ratio 9:1.* This ratio cannot be altered as Molasses is a binding agent and mixing of molasses in higher ratio or in lower ratio would result into very hard or very soft product which cannot be used for cattle feed. After making reverse calculation, total production was determined. During the course of assessment proceedings, the Assessing Officer (AO) noticed that though the assessee was engaged in manufacturing activities, no quantitative records in respect of production were maintained. This was also stated in the Audit report. The details submitted by the assessee revealed a shortage of 3,06,479 kg in finished goods. To a query by the AO, the assessee claimed that main ingredients of the cattle feed *viz.* Haller Rice Bran & Rice Bran Cutting have moisture content. These along with groundnut waste and calcium are mixed with the molasses in the ratio of 9:1. The assessee attributed the reasons for the shortage of 3,06,479 kg to the raw material

having moisture content which evaporates if not used immediately for production besides loss of weight in handling and transportation. However, the AO concluded that all the items of raw material used for making the cattle feed pellets have high absorbing power and the only liquid used as submitted by the assessee was molasses, which was also in fact a semi liquid and that the day to day consumption of molasses vis-à-vis the production did not suggest that the assessee had stored the goods for a long time. Accordingly, the AO computed shortage of 2,25,509 kg after considering the submissions of the assessee, resulting in addition of Rs.10,41,852. The said addition was confirmed by ITAT.

11.4 Case Study-3

A major modus operandi was detected in the manufacturing of 'CPC' (Copper Pthalocyanine Crude) Blue. The modus operandi was diversion of agriculture grade Urea, meant for use by farmers, to manufacturers of CPC Blue Pigments meant for industrial purpose. The price of agriculture grade Urea, which is most prominent amongst fertilizers used by the farmers in India, is highly subsidized and attracts Central Excise duty @ 2%. Such agriculture grade Urea is manufactured in the state of Gujarat by various Urea manufacturers like (i) Krishak Bharati Cooperative Limited (KRIBHCO), (ii) Gujarat Narmada Valley Fertilizers Company Ltd. (GNFC), (iii) Gujarat State Fertilizer & Chemicals Ltd. (GSFC), (iv) Indian Farmers Fertilizer Cooperative Limited (IFFCO) etc. However, the price of Urea, which is also an essential ingredient to manufacture CPC Blue Pigment meant for industrial use is not subsidized and attracts full rate of Central Excise duty i.e. @ 12% e.g. the rate of agriculture grade Urea is around Rs. 5.36 per kg. and the rate of technical grade Urea (imported) is around Rs. 32 per kg. Government is heavily subsidizing UREA which can be seen from the rates as mentioned above. Certain CPC Blue manufacturers in connivance with some dealers/ traders of industrial grade Urea and distributers of agriculture grade Urea have indulged themselves in receipt and utilization of such agriculture grade Urea, illicitly, in the guise of technical grade Urea and/ or any other industrial chemical product like T-Salt, refined Salt, pure Salt, Silica, Caustic Soda etc.

11.5 Case Study-4

A Pesticide company having turnover of Rs. 35 crores per annum was engaged in manufacturing of Pesticides, Fungicides, Herbicides and Insecticides.This company was selling its products in Madhya Pradesh, Rajasthan, Punjab and South India either through its own Depot or through stockists. The company assessee was searched by DGCEI for evasion of Central excise and had also paid substantive Excise duty on the evasion detected by the DGCEI. The DGCEI had detected that the assessee is involved in excise duty evasion by way of clandestine removal of finished goods from the factory premises of M/s XX Pesticides Ltd. The assessee was also removing the excisable goods in the name of a dummy concern opened in the name of one of the director. Further, during the course of search of DGCEI the statement of one employee was recorded and he has admitted that:

> *"in the end of each month, our director used to give him direction as to how many central excise invoices are to be prepared and for which amount and for which party and based on his direction I used to generate such central excise invoices".*

He has further stated that the daily stock register was prepared doing reverse adjustment entries which will never tally with their actual daily production figure.

11.6 The undisclosed G.P was offered to tax before Income-tax department by the company. Besides this, while scrutinizing the documents received from the DGCEI it was noticed that one person named Shri ABC, Prop. Of YY Chemical,

who was a dealer of M/s XX Pesticides Ltd had given statement that all the payments made to M/s XX pesticides Ltd was deposited in a Bank account maintained in the name of XX Pesticides Ltd. On further verification, it revealed that this bank account was not reflected in the books of accounts of XX Pesticide Ltd. The transactions made in the said bank account could not be explained by the assessee. Enquiries were made in other banks also and mobile numbers and the email addresses, name and address of all directors were provided to Bank and it was asked to furnish all the bank accounts related to mobile numbers and the email addresses, name and address of directors. This exercise yielded result and 20 undisclosed bank accounts were detected in four banks. The assessee finally admitted that all these bank accounts were opened either in the name of XX Pesticide Ltd or in the names of family members and employees and all these bank accounts are undisclosed bank accounts. He has further stated that the unaccounted transactions of XX Pesticide Ltd were made through these bank accounts and most of the deposits related to unaccounted sale and withdrawals were related to purchases/personal withdrawals. Total credits of Rs. 37,00,00,000/- approx were found to have been made from Assessment Years 2009–10 to 2016–17 in these bank accounts. The assessee has now filed application before Settlement commission.

12. CONCLUSION

It can be concluded that there are many instances of tax evasion in chemical industry as a whole. The Assessing Officers should thoroughly familiarize themselves with the production processes and the standards applicable and look for things, which are at variance with the normal parameters and are indicative of abnormal trends/ practices which should be subjected to in-depth scrutiny before they are accepted.

CHAPTER

10

Jewellery, Bullion & Precious Stones

1. INTRODUCTION

1.1 Since time immemorial India has been an important world centre of gems and jewellery manufacturing. For its wealth of design and exquisite craftsmanship, Indian jewellery is unrivalled.

1.2 The Gems and Jewellery industry has significant role in the Indian economy. It contributes around 7% to the country's GDP. This sector is home to more than 3,00,000 gems and jewellery players. It is one of the fastest growing sectors which is extremely export oriented and labour intensive. The business has created $30.96 billion of income in 2018–19, making it the second biggest exporter after petrochemicals. India's Gems and Jewellery division has been contributing largely to the nation's foreign exchange earnings (FEEs).

It employs over 4.64 million workers of organized and unorganized sector.

1.3 Under the general category of Gem and Jewellery trade, there are the following important branches-Diamonds; Precious stones such as rubies, sapphires, emeralds etc.; Semi-precious stones; Pearls-cultured and real, Gold, silver and other precious metals; Stone-studded precious metal jewellery of gold, silver, platinum, palladium, etc.; Imitation jewellery and costume jewellery; Manufacturing of precious metal art objects including silverware, cutlery, plate ware, utensils, etc.; Synthetic stones; Jewellery made of natural materials such as coral, wood, jade etc.; Tourist trade of jewellery.

'Carat' is a term expressing the ratio of precious metal to base metal in an alloy, also a unit of weight for precious stones. In the first sense, a carat (usually spelled Karat) indicates 1/24 part by weight of a precious metal, such as gold, in an alloy. Thus, 18-karat gold is 18/24 (or ¾) gold, and 24-karat gold is pure gold. As a unit of weight for precious stones, the international metric carat, now used by most countries, was standardized by the US government in 1913 at 200 mg, or 0.2 g. This standard carat is divided decimally, 0.01 carat is usually called a 'Point'.

Jewellery as a product can be classified in various categories such as pure Gold Jewellery, Diamond Jewellery, Kundan Jewellery etc.

1.4 Various methods of Jewellery making are:

i. **Handmade:** In this process the Jewellery is made by hand, without the aid of mechanical devices other than ordinary hand tools.

ii. **Cast:** The method in which metals are poured or forced into moulds, which have cavities in the shape or form of the articles to be produced.

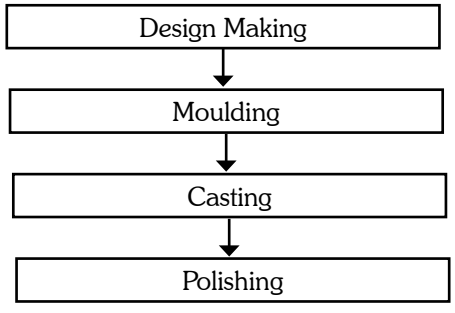
iii. **Die Struck:** The method in which metals are mechanically hammered into hardened steel dies to produce definite impressions.

iv. **Gold Filled and Rolled Gold Plate:** Continuous plates of metal are covered mechanically by means such as soldering, brazing, or welding. The carat gold used is at least 10 carat fine, and this gold covering can be applied to one or more surfaces of the base metal. Many quality costume Jewellery manufacturers use this process to imitate the carat gold look of fine Jewellery. Gold filled or rolled gold Jewellery is not as durable as carat fine Jewellery, however, because the actual layer of gold on the item is extremely thin.

v. **Gold Electroplate:** Electroplate is the process of affixing a plate or layer of fine gold on a base of metal by an electrolytic process using electricity and chemicals.

2. JEWELLERY MANUFACTURING PROCESS

2.1 Jewellery manufacturing process may be exhibited with the help of the following chart:



Following is a brief description of all the processes involved in the manufacturing chain.

2.1.1 Design Making

The designer's concept and drawings are used by the model maker to create the original piece of Jewellery.

2.1.2 Moulding

i. Once the master piece of Jewellery is complete, it is used to make a high technology mould, which in turn is used to make wax reproductions of the Jewellery.

ii. After the sketch is complete with all the fine details, it is passed on to the moulding Section in the moulding department, the very experienced professional moulders then turn the sketch into a master mould which sets the base for the total process there from. The master mould is a very complex level of crafting as the final outcome rests on the master mould.

2.1.3 Casting

Casting again is a very complex process and requires utmost skilled and experienced casters for the desired final product. The wax replicas are placed in steel containers which are then occupied with a chemical powder and the containers are heated in a chamber to 550°C which solidifies the powder and melts the wax leaving behind a perfect effect. Liquefied metal is then poured into the flasks, allowed to cool, then demolished to reveal the Jewellery in casting form.

2.1.4 Polishing

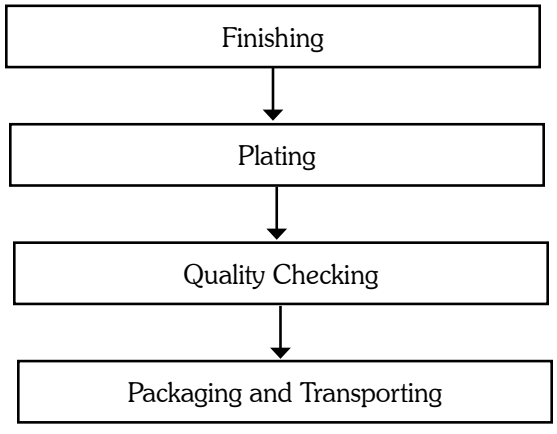
Every part must be polished while the mount is being made. The entire mount is carefully made clean and polished to the highest degree of smoothness so that each and every part is attractively polished. After stage setting, the Jewellery is polished for a fine finish. All tinctures

of the polishing compounds and 'rouge' must be meticulously got rid of either by careful washing by hand or by use of supersonic cleaning baths.

3. EMBELLISHMENTS/ DECORATIVE PROCESSES

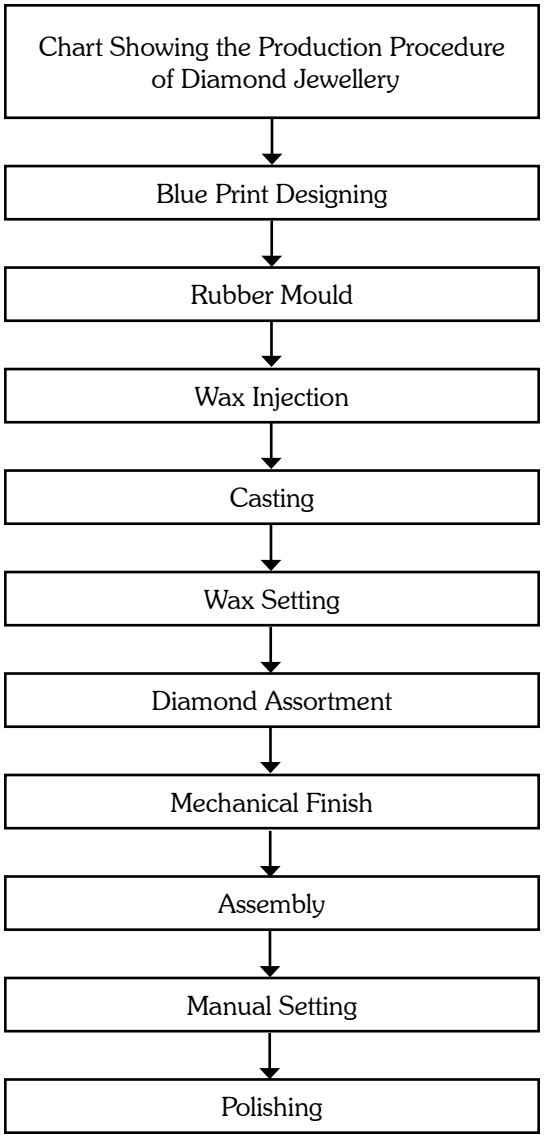
3.1 After the product has passed from the polishing and finishing departments, it has to undergo embellishment process. When the products gets cased and foiled, the required decorative stones of the correct sizes and weight are cut and made with extreme preciseness and assorted for the final setting which is done once the products leave the foiling and finishing department.

3.2 It requires immense patience and skill to make the master-model and to produce an exquisite casting free from defects and which needs the minimum of chasing to make it perfect. Applied wire can also be used as inherent decoration.



4. PRODUCTION PROCEDURE OF DIAMOND JEWELLERY

4.1 When Diamond Jewellery is manufactured a standard production procedure is followed from making rubber mould and ends with polishing the final piece. It can be exhibited with the help of the following chart:



4.2 The production procedure of diamond jewellery can be explained as below:

4.2.1 Blue Print Designing

This is the point from where the process begins. This process of Blueprint Designing is carried out by efficient and experienced craftsmen using techniques and methods handed down over decades. The start concept is basically a rough design in the mind of the designer. The final design is the result of close cooperation between designer and craftsman. The designer's concept and drawings are used by the Model maker to create the original piece of Jewellery.

4.2.2 Rubber Mould

Once the master piece of 'Diamond Jewellery' is complete, it is used to make a high technology rubber mould. After the sketch is completed with all the fine details, it is passed on to the moulding Section. In the moulding department the very experienced expert professional moulders turn the sketch into a master mould which sets the base for the total process. The master mould is a very complex level of crafting as the final outcome rests on the master mould.

4.2.3 Wax Injection

This is again a very complex process and requires utmost skilled and experienced casters for the desired final product. The wax replicas are placed in steel containers which are then occupied with chemical powder and the containers are heated in a chamber at a temperature of 550° centigrade which solidifies the powder and melts the wax leaving behind a perfect effect.

4.2.4 Wax Setting

After the application of the wax it is set in the mould according to the design.

4.2.5 Diamond Assortment

After wax setting diamond assortment is made because the diamond piece/ pieces are required to be fitted in this Jewellery according to the size and shape of the diamond.

4.2.6 Mechanical Finish

A mechanical finish is required to be made as the mould cannot be exact according to the size and cut of diamond. This mechanical finish ensures the appropriate space and gap for fixing a diamond in the Jewellery.

4.2.7 Assembly

Now the work of assembly is done with the help of these parts in the form of gold part and diamond piece. A required change may be needed at this level. This work of assembly is done with the help of machines.

4.2.8 Manual Setting

In some cases where the piece of the diamond is a bit big it is set with manual help. The reason of such requirement is that machines deal with a standard size of diamond and in case of specific size and cut a manual setting is required.

4.2.9 Polishing

After finishing the assembly work every part must be polished while the mount is being made. The entire mount is carefully made clean and polished to the highest degree of smoothness so that each and every part is attractively polished off. All chemicals of the polishing compounds must be thoroughly get rid of either by careful washing by hand or by use of cleaning baths.

4.2.10 Tools & Technology for Gems & Jewellery

i. This particular Section deals with the introduction of new tools and technology for superior and more production.

ii. With the sweeping changes, many modern machines, electronic and laser gadgets and advanced tools are appearing in Indian factories because in a keenly competitive world where more and more rivals are emerging, India cannot afford to lag behind. So India has even started manufacturing a number of modern tools and machinery, computers and innovative software.

iii. Lately many Indian and foreign training institutes some of them run by India's Gem & Jewellery Export Promotion Council and others of the private sector, have been established to train newcomers in latest technology. A Coimbatore-based trade body the Gems & Jewellery Machinery & Accessories Association has been organizing tools and technology exhibitions at various manufacturing centres of the country to introduce and popularize new scientific aids for the precious sector.

5. SOURCES OF INFORMATION, DATA COLLECTION/ COLLATION LIKE SEBI, GST, EXCHANGE OF INFORMATION, ETC.

Detailed information on this trade for purposes of investigations can be collected from the following agencies:

i. REIC/ CEIB

ii. Directorate of Revenue Intelligence

iii. Financial Intelligence Unit-India

iv. Directorate of Enforcement (Foreign Exchange)

v. Gem and Jewellery Merchants Export Promotion Council

vi. State Trading Corporation

vii. All India Handicrafts Board

viii. Reserve Bank of India

ix. Gem and Jewellery Information Centre, Journal House, Janta Colony, Jaipur-302004

x. FT&TR (Foreign Tax and Tax Research)

6. PROFIT MARGINS AND RATIO ANALYSIS

Actual net profit in diamond manufacturing is in the range of 1.5–3.5% and in diamond trading in the range of 1–3%. The margins will possibly decline even further, as rough producers have been constantly keeping their prices high.

7. RELEVANT, CBDT CIRCULARS AND INSTRUCTIONS

7.1 Circulars, Notifications, Instructions and Press Releases

i. Press release dated 15/12/2015

Section 139A – Permanent Account Number – amendment of rules regarding quoting of PAN for specified transactions.

ii. Circular No. 1 of 2015 dated 21/01/2015

Estimate of value of assets by Valuation Officer and time limit for completion of assessments where reference made.

iii. Circular No. 3 of 2014 dated 24/01/2014

Removal of exemption from levy of Tax Collection at Source (TCS) to cash sale of any coin or any other article weighing 10 grams or less.

iv. Press release dated 01/05/2013

Collection of Tax at Source-Finance bill, 2013-clarification on amendment to Section 206C of the Income-tax Act dealing with tax collection at source (TCS) on sale of bullion or jewellery in cash.

v. Instruction F. No. 286/247/98-IT(Inv. II), Dated 02/02/1999

It deals with the cases of seizure of declared assets, the seized assets could be released subject of course to recovery action by the department against existing arrears.

vi. Instruction No. 1916, dated 11/05/1994

This instruction deals with the seizure of gold jewellery and ornaments during the course of search and seizure action.

vii. Circular No. 646, dated 15/03/1993

Requirement of obtaining report of registered valuer for value of jewellery exceeding Rs. 5 lakhs.

viii. New Valuation Rules-Press Note, dated 27/01/1989

Jewellery details will have to be furnished in the prescribed form and will be subject to reference to valuers wherever it exceeds Rs. 5 lakhs in value. Once it is so valued, no reference will be necessary for next four years subject to the price of gold.

Press Note: *Issued by the Government of India, Ministry of Finance (Department of Revenue), Central Board of Direct*

Taxes, dated 27th January, 1989. (extract of paras 21 and 22).

ix. Instruction No. 2/2008

Section 143 of the Income-tax Act, 1961, Assessment–Assessment procedure for assessee engaged in diamond manufacturing and/ or trading

x. Circular No. 3 of 2017 dated 20/01/2017

Exemption in respect of certain activity related to diamond trading in "Special Notified Zone".

8. INCOME COMPUTATION AND DISCLOSURE STANDARDS (ICDS)

CBDT vide its Notification No: 32/2015 dated 31/03/2015 notified 10 Income Computation and Disclosure Standards (ICDS); which are to be followed at the time of computation of income chargeable to Income-tax under the head "Profit and gains of business or profession" or "Income from other sources". The effective dates of these ICDSs are 01st April, 2015 and shall accordingly apply to the Assessment Year 2016–17 and subsequent assessment years.

PRECIOUS STONES & GEMS

a. INTRODUCTION

Sapphires, Emeralds, Diamonds, Zircons, Rubies, Peridots, Opals, Jades, Turquoises, Corals, Agates, Amethysts, Cat's eye, Aquamarines, Garnets, Topazes and Citrines are some of the important and well known precious and semiprecious stones. Shape, brilliance and rarity count for everything when it comes to the selection of a gemstone.

b. MARKET SIZE

During the same period, exports of cut and polished diamonds stood at US$ 17.2 billion, thereby contributing about 69 per cent of the total gems and jewellery exports in value terms.

Table 1: Precious and Semi Precious Stones and Gems

Gem Material	Common Names
Diamond	Diamond
Corundum	Ruby
	Sapphire
Beryl	Emerald
	Aquamarine
	Golden Beryl
Topaz	Topaz
Garnet	Almandite
	Pyrope
	Demantoid
	Hessonite
Tourmaline	Red tourmalime
	Green tourmaline
Peridot	Peridot
	Chrysolite
Chalcedony	Chalcedony
	Agate
	Onyx
Spinel	Ruby spinel
	Blue spinel
	Flame spinel
Chrysoberyl	Alexandrite
	Cat`s-eye
	Yellow chrysoberyl
Zircon	Jacinth or Hyacinth
	Jargon
Opal	Black opal
	White opal
	Fire opal
Quartz	Amethyst
	Citrine
	Tigereye
	Cat`s-eye
	Jasper
Turquoise	Turquoise
Nephrite	Jade
Jadeite	Jade

i. India is the biggest manufacturer of Diamond in the world and India also

manufactures very fine ruby and emerald for global exports. Apart from this, it also turns out other gemstones like tourmaline, garnet, peridot, moonstone, aquamarine and various other semiprecious gemstones.

ii. 'Emerald' is a green gem variety of the mineral beryl having a hardness of 8 and a specific gravity of 2.7 to 2.9. It is essentially identical to other types of beryl in composition and properties, but contains sufficient chromium to impart a bright green color.

iii. 'Ruby' is a precious stone that occurs as a red, transparent variety of the mineral corundum. Clear stones of the deeper shades are the most highly prized.

iv. 'Garnet' is a general name of a group of related minerals, often used as gemstones and abrasives. Garnets crystallize in the isometric system, usually as rhombic dodecahedrons, tetragonal trisoctahedrons or combinations of the two. The different varieties of garnet exhibit almost all colors except blue. Brown, red, green, yellow, black and colorless stones are common.

v. 'Topaz' is a variety of mineral aluminium fluodilicate, crystallized in the orthorhombic system and valued as a gem. It has a vitreous luster and may be colourless, yellow, green, blue or red. It has a hardness of 8 and a specific gravity of 3.4–3.6. The crystallized varieties, owing to their hardness, are valued as gems and the best of these come from Sri Lanka and parts of India, the Ural Mountains in Russia, and Minas Gerais State, Brazil and in the US from Maine, Colorado and Utah.

vi. 'Sapphire' occurs as a transparent, blue variety of the mineral corundum. Although the term sapphire is often applied to gem-quality varieties of corundum of all other colours, the true sapphire is deep blue, the best tint being a cornflower blue called Kashmir blue.

vii. 'Imitation' diamond The most common imitations are those made of a form of lead glass known as paste or straws. The better glass imitations are cut and polished like true stones, but cheaper counterfeits are moulded in the form of brilliants and consequently have rounded edges. Any glass imitation can easily be identified. They resemble true diamonds but can be scratched by them.

9. BUSINESS OPERATION/ PROCESSES—KEY PARAMETERS & DRIVERS OF INDUSTRY

Gemstones are often treated to enhance the color or clarity of the stone. Depending on the type and extent of treatment, they can affect the value of the stone. The processing of Gemstones:

i. **Heat:** Nearly all tanzanite is heated at low temperatures to remove brown undertones and give a more desirable blue/ purple color. A considerable portion of all sapphire and ruby is treated with a variety of heat treatments to improve both color and clarity.

ii. **Radiation:** Virtually all blue topaz, both the lighter and the darker blue shades such as "London" blue, has been irradiated to change the color from white to blue. Most greened quartz (Oro Verde) is also irradiated to achieve the yellow-green color. Diamonds are irradiated to produce fancy-color diamonds (which occur naturally, though rarely in gem quality).

iii. **Waxing/ Oiling**: Emeralds containing natural fissures are sometimes filled with wax or oil to disguise them. This wax or oil is also colored to make the emerald appear of better color as well as clarity. Turquoise is also commonly treated in a similar manner.

iv. **Fracture Filling:** Fracture filling has been in use with different gemstones such as diamonds, emeralds and sapphires.

v. **The Rough:** The whole process begins with the rough crystal. Crystals come in many different shapes and forms. Some are still in their "crystal habit" (the natural form in which a particular gem mineral develops) others have been broken by the mining process or by nature itself with the twisting of the rock in which it formed. Others still, are alluvial and carry the appearance of water worn pebbles. (Fig. 1)

   a. **Various Shapes of Rough:** Recent rough crystals seen in Lapigems Offices, world famous Gems Company based in Nairobi. From left-Alluvial Malaia Garnet, random shapes of Tanzanite and Tsavorite and a Tourmaline in its crystal habit.

   b. Less rare gems, produced in quantity and smaller sizes are often cut as calibrations—standard sizes. In the case of these cuts, the principal consideration is a uniform size-an 8 x 6 oval for example. The fine gemstones are very rare and expensive and a cutter will try to maximize the yield he gains from a piece of rough in order to minimize loss of weight-weight is money.

   c. The process of cutting fine rough into a scintillating finished gemstone is called faceting. The steps taken to achieve this are considered below.

vi. **Planning the Cut:** This is a very important step. The cutter will consider the shape of the rough and the inclusions within it. Once the cutter has examined the piece thoroughly he will begin to clean the stone up. If a piece requires slicing it will be done with a special machine. Otherwise included areas are ground off with a special lap.

vii. **Preshaping & Doping:** Next comes preshaping—this is a skilled art. It is done "freehand"—the cutter holds the rough stone in his hand and grinds it using a spinning wheel called a "lap" primed with diamond powder. This will produce the very basic shape of the cut.

   a. The preshaped piece of rough is now attached to a special metal rod called a dope. Special doping wax is used to do this. The doped rod is then connected to a handheld faceter (Fig. 2).

   b. **From Rough to Doped:** From left-A rough crystal being examined before cutting. Middle Pic-Preshaping on a specialized lap. Right-Preshaped stone is doped-placed on a doping stick with the aid of special gem cutting wax. (Photo Lapigems 2010).

viii. **Faceting:** The next step is faceting where the gems are polished further. This is a very skilled process where a cutter places a number of carefully placed facets (or faces) onto the table and pavilion of a gemstone (Fig. 3).

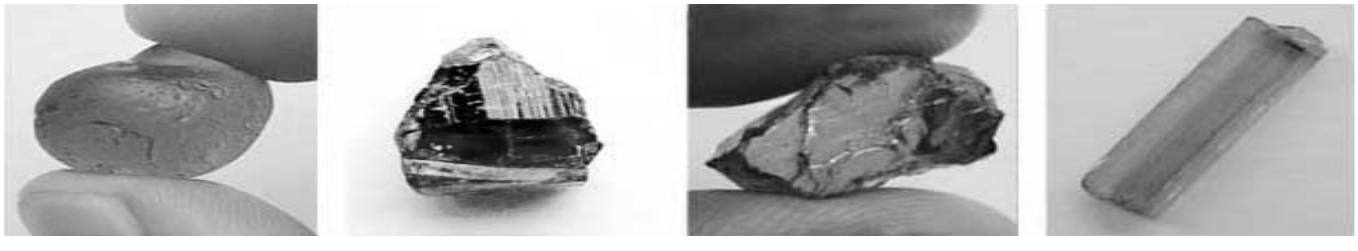


Fig. 1

Fig. 2

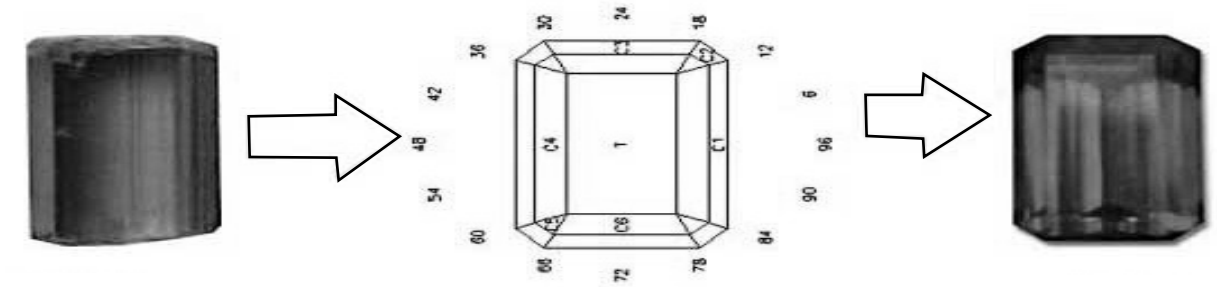


Fig. 3

ix. **Rough to Cut**: A Rough Tourmaline pencil in its "crystal habit" lends itself well to an emerald cut (Octagon). The emerald cut maximises weight retention where another cut would incur unnecessary weight loss.

The crown and pavilion are essentially cut to form a lens and reflector. They gather and focus the light, then reflect it back at the *eye*. The crown facets form the lens, gathering the light from all directions and focusing it on the pavilion which becomes the reflector, bouncing light around inside the stone and then back upwards via the crown and out to the *eye*.

x. **Faceting and Polishing:** Different minerals have different requirements and a cutter must be aware of these. This is because different gems have different critical angles. To explain-the angles used for each facet denote the final result achieved, in that they affect the brilliance and reflection a gemstone is capable of.

xi. **Polishing:** This is the final stage. The cutter will use a special polishing lap which is even finer than the faceting lap. It is also primed with very fine diamond powder. Each facet is then polished individually to a high sheen, giving the stone a fine luster.

TAX INVESTIGATIONS

Both goldsmiths and jewellers, who play a pivotal role, belong to a specialized class of traditional artisans catering to the needs and vanities of men and women.

i. Goldsmiths can be classified into following categories:

a. Petty goldsmiths who manufacture ornaments of private individuals or jewellers.

b. 'Niariyas' who convert old ornaments into pure gold either on behalf of private individuals or jewellers.

c. Goldsmiths who maintain small workshop and manufacture ornaments

comparatively in large quantity, mostly for jewellers.

d. Goldsmiths who manufacture ornaments in comparatively large quantity from gold of their own, and sell the same to the jewellers in bulk either in cash or in terms of gold plus manufacturing charges.

ii. Most of the goldsmiths maintain a small diary popularly known as '*karigar bahi*'. This notebook normally contains the details of pure gold received from jewellers and variety required by him, and the delivery of jewellery made from time to time. Most of the times, the jewellers themselves keep their '*Niariyas*' on salary basis for getting the old ornaments converted into pure gold to have a direct check on conversion.

9.1 The last two categories of goldsmiths mentioned above, make profit over and above the manufacturing charges received. Some of the ornaments are studded with stones and it is not possible for the dealer to keep record of the weight of all the stones, or the stones are purchased by the goldsmith himself on behalf of the dealers (Jewellers). The dealers are generally guided by the weight of gold as declared by the goldsmiths in various articles. It is possible that the goldsmiths might estimate the weight of the stones at a higher figure and may reduce the weight of gold contained in articles, thus, making extra profit out of it.

9.2 Some articles are decorated with colour known as '*Meena*' in the traditional language. Generally such ornaments are supplied at the weight of the gold including '*Meena*'. Gold, to the extent of the weight of '*Meena*' in the article, is thus saved by the goldsmiths. But the weight of '*Meena*' is so negligible that on its basis it is difficult to prove that any gold was actually saved by the goldsmiths. If the relevant data is recorded in the books maintained by goldsmiths the same can be utilised for the purpose.

9.3 The ornaments are supplied on gross weight including the weight of '*Tanka*' i.e. impurity (alloy content). The gold to the extent of the weight of 'Tanka' is thus saved and is generally not disclosed in income.

9.4 In a case, where the goldsmith is manufacturing ornaments from his own gold and is selling the same to jewellers, profit is also earned in the form of *saving in weight of stones and saving in the form of alloy mixed with gold* over and above what is accounted for by the jeweller. If the ornaments are sold in cash, the element of profit due to rise in price of gold gets reflected in the accounts; but where the ornaments are converted into equal weight of gold and labour charges are incurred, the element of profit due to rise in price of gold is suppressed by adopting the value of opening stock/ closing stock as in the past and showing only the job receipts. Each transaction is a transaction of composite sale, partly in cash and partly in kind, and hence the element of profit due to rise in price of gold should be detected and assessed to tax.

9.5 In a number of cases, goldsmiths enter into collusive transactions with the jewellers. The goldsmiths have been, at times, found to be inflating the *'making charges'* as against the actual amount received from the jewellers, and even receipts for inflated charges are issued to the jewellers, unmindful of the consequences, since petty goldsmiths are not assessed to tax. A test check of goldsmiths' accounts often proves rewarding.

9.6 It is important in the assessment of goldsmiths to verify *whether they had actually manufactured* the ornaments shown in the account books, or only fictitious entries of collusive nature were made. Therefore, it becomes necessary that the Assessing Officer should verify as to how gold was received by them and how the ornaments manufactured were supplied to the jewellers. Jewellers can be classified into the following categories:

i. Dealers in gold and silver ornaments studded with or without imitation stones.

ii. Dealers in jewellery studded with precious or semiprecious stones.

iii. Dealers in fashion jewellery and accessories.

9.7 Investigation required in the first two types of cases is almost similar. Before investigating the case, the Assessing Officer must obtain a day-to-day record about fluctuations in prices. This is important because for example, if a jeweller has stock of about Rs. 2 lakh on a particular day and if the prices go up by 25%, he makes a profit to that extent as and when the goods are sold out of the stock available on that day. Therefore, the margin of profit on the sale of such articles should be 25% plus the normal rate of profit earned in the regular course of business. The jewellers almost repeat the same margin of profit from year to year and the same is accepted by the Department mostly.

9.8 Fashion jewellery and accessories are normally made of 16 to 18 carat gold with embedded gems of inferior quality. Most of the fashion jewellery is being sold with 100% buy back guarantee. But a very heavy labour cost is normally charged at the time of sale of such articles. Moreover, the cost of the stones is also charged at very high rates.

9.9 After the abolition of the Gold Control Act, 1968 the jewellers are not required to maintain the statutory registers regulating and controlling their business. Now Non-resident Indians returning to India are allowed to bring with them gold upto 10 kg, by payment of nominal customs duty of Rs. 470/-per 10 gm. The NRIs can bring this gold in six months. This free import of gold through NRIs has reduced the differential cost structure of gold and silver in India and abroad. The Gold Control Act was such a tool, placing restrictions on private ownership as well as trading of the gold. In the liberalised economy, gold has no longer remained a sensitive item for the traders as well as for the owners. The Government has benefitted by allowing free import of gold through NRIs, by way of customs duty. Besides, since the price differential between gold price in India and abroad has narrowed, black market transaction have ceased to be attractive, thereby curbing smuggling of gold. Gold in pure form is now available for counter sale in Reserve Bank of India and also specified branches of State Bank of India.

9.10 Dealers in gold also normally deal in silver ornaments and jewellery. In case the silver ornaments are too impure or old fashioned to be sold as such, they are sent to refineries for extracting pure silver, and the refined silver is issued for making ornaments. A cross check with the refineries would establish the genuineness of the assessee's claim for refining the silver ornaments.

i. Silver refineries are normally found in all important trading centres and they are often run on co-operative basis or by 'Mahajans'. The account books maintained by the refineries can, therefore, be fairly reliable. Refining is done only after getting the certified weighment. After refinement, receipts are issued for exact quantity of silver refined. The accounts maintained by refineries, can, therefore be put to good use in investigation of cases of silver merchants. Most jewellers do pawning business also. They advance money on the security of gold/ silver ornaments. The Assessing Officer would do well to examine the alleged owner, mainly ladies, who may not be the real owner to find out:

   a. what she actually does.

   b. whether she knows about this business. whether the investment represents her '*streedhan*' or is actually the capital of jeweller.

   c. the manner in which the income from the pawning business is utilised.

ii. Whenever any extra stock is found in the shop, it is claimed to be pawned ornaments and subsequently the assessee brings forth a debtor who states to have pledged the ornaments. Such claims should be thoroughly scrutinized before these are accepted at face value.

9.11 Often quite a few debtors are unable to pay back the loan taken plus interest due thereon and leave the ornaments for good. The assessee shows that the ornament has been released and credits interest accrued to profit and loss account. The same ornaments are then shown as purchased at market price in jewellery business. Thus, the assessee suppresses the pawning income on account of forfeiture of pawned ornaments. And, it also introduces bogus purchases of such forfeited articles. In such cases, confronting the jeweller with the debtor(s) may bring out the true position. There are some jewellers who deal in silver in local as well as foreign markets. In foreign market, they sell silver on forward delivery. If they suffer loss the same is claimed as loss of hedging on the ground that silver sold for future delivery was less than the silver in stock, but while calculating the weight of stock they include the stock in local trading account also. In such cases, the assessee should be asked to give stock position of foreign trading only, and if the stock therein was less than the weight of silver sold on the date of transaction, loss suffered therein should be disallowed.

9.12 A number of manipulations have been observed in the cases of jewellers. The stock registers maintained by jewellers are useful as they are maintained on the basis of the weight of the metal and normally any increase due to addition of impurities is shown on the gross basis. For example, if jeweller purchases bullion weighing 1 kg and the same is given for ornament making then the ornaments received back from the gold smith is also shown as weighing 1 kg. This kind of stock maintenance is faulty since on account of inclusion of impurity in the making of ornaments, the gross weight of the jewellery increases. Normally, it should be in the range of 1100–1250 gm for every kilogram of bullion, depending upon the type kind of jewellery and the carat. In the cases of studded jewellery the weight of the stone is normally written separately. However, it is not ascertainable. These lacunae often enable the jeweller to sell jewellery with a less quantity of gold than that mentioned in the sale bill. Bogus purchases are then introduced to lower the GP rates.

9.13 In schemes of gold deposits are apparently only a tool to increase the stock in the books. Most of the schemes offer an interest rate of about 2–4% only as compared to the market rates of 12–18%. Therefore, it is unlikely that any prudent investor will deposit his gold with a jeweller for the interest rates of 2–4%. It is therefore important to investigate such deposits. If in the course of search or survey operations such deposits are found then simultaneous enquiries may prove very beneficial for the revenue.

9.14 Many jewellers have their own "*niariyas*" who convert gold ornaments into pure gold. Such "*niariyas*" are using small crucibles popularly known as '*muse*' for melting ornaments and also for mixing or removing the impurities i.e. copper. This crucible is made of a special kind of clay and normally for every 100 gm. of gold melted, about 300 mg is wasted or is mixed with the clay of the crucible (gold dust). Such clay is stored by the jewellers, and they recover gold from this clay of muse every 2–3 years. This recovery can be upto 2–4 kg of gold in the cases of jewellers having gold stock of 15–20 kg. This applies to gold smiths also.

9.15 Most jewellers show low turnover trading account, even when having large closing stock. These traders show inventory-turnover ratio of 2–3 as against the normal inventory-turnover ratio of 0.2–0.25. The main reason behind suppression of the turnover is the high sales tax on sale of jewellery. To cover up this part, jewellers show a high GP of 20–25%, inspite

of low sales shown by them, and stock is tried to be merged due to fear of survey and search operations. Some jewellers also book sales as repair of old ornaments which also needs to be investigated in an appropriate case.

9.16 Most jewellers engage in pawning business also. Sometimes the undisclosed or unexplained stock of the jewellers is kept in the form of pawned articles against fictitious names. Therefore, 'girvi' or pawning register should be examined to verify if small amounts have been lent against some precious jewellery or bullion. If such instances are noticed then the person borrowing the money should be located and examined.

9.17 Sometimes jewellers claim during surveys that personal jewellery of ladies of their family is kept in the shop. If such plea is taken, then specific items belonging to the ladies of the family should be ascertained, and verified from the concerned member of the family.

9.18 Any unusual purchase of old jewellery by a jeweller from any person needs to be examined with regard to the availability of the gold or jewellery with the seller(s). The incoming and outgoing of the stock should be verified with reference to purchases and sales. The inventory drawn at the end of the accounting year should also be checked with reference to the stock position given in the stock register. In one case, a jeweller was valuing the stock at market price, but due to sudden rise of price of gold/ silver in a particular year, there was abnormal profit. In order to reduce the profit in that year he started valuing the stock at cost.

9.19 Any abnormal quantity of ornaments sold by an assessee on any particular day requires verification by the Assessing Officer. Generally when there is abrupt increase in the price of the gold/ silver the assessee may like to show large sales of ornaments at lower rates prevailing on earlier dates. If the goods are sent on approval in large quantity, necessary verification should be made from the purchasers. The assessee must be maintaining some subsidiary book for recording the details of goods sent for approval and the same should be thoroughly checked.

9.20 Sometimes, customers give old ornaments to jewellers for converting them into new ornaments. In such cases, jewellers only charge manufacturing expenses and for this purpose maintain a record. Such record should be scrutinized for ascertaining the genuineness of transactions. Often jewellers introduce their unaccounted stocks by this method to eliminate any query regarding the source of purchase.

9.21 Certain interesting features came to light in a major group of Kerala. This group has a string of jewellery shops in central and north Kerala and in six places in the Gulf countries. It also has three jewellery export units in India. It purchases gold from the MMTC. It is supposedly converting this gold into fashionable ornaments and exporting them to the Gulf. During the assessment proceedings the Inspector noticed that the firms of the group were showing regular purchases of new gold from NRIs visiting India. Under the present dispensation each NRI is permitted to bring into the country 10 kg of gold subject to payment of customs duty. The accounts of these firms showed that they affected the purchases from the NRIs, paid the duty and used the gold for their businesses. The NRI gold thus bought in one year by the firms amounted to one and a half quintals. Each NRI seller was getting nearly Rs. 40 lakh as sale price of gold from the group. Payments to the NRIs were being made through crossed account payee cheques. On enquiries with the bank, it transpired that the moneys in all these cases were withdrawn by the NRIs on the very days of credit to their accounts. When contacted, the NRIs could not satisfactorily explain the sources of their funds for purchase of the gold which in each case came to the rupee equivalent of Rs. 30 lakh approximately. Also, they could not explain the manner in which the amount withdrawn from the bank was spent. In some instances the NRI was the overseas employee of the group. Thus,

all necessary ingredients for suspicion were present. Confronted with these facts, the group conceded that it was the exported jewellery which was brought back into India in the form of NRI gold.

9.22 Some jewellers also deal in silver bullion. They purchase old silver ornaments and after melting the same sell to various dealers. If the price of silver is slightly higher at outstations, the jewellers send silver 'thakias' i.e. bullion in large quantity through their messengers, who carry a voucher also. However, if silver carried by the messengers is detected/ intercepted on the way either by the Police Department or by the Income-tax Department, they immediately record the transaction in their stock register and overcome the difficulty. Therefore, if silver bullion is found or seized by any Department, it is necessary that the stock register of the seller should be signed at once and his statement recorded otherwise the seller will make necessary entries in the stock register. In important cases if there is no entry in stock register, it would be better to survey the premises under Section 133A for finding out the actual stock with the assessee on that particular date and compare it with stock register.

10. AREAS OF TAX EVASION BOTH FACTUAL & LEGAL ALONG WITH MODUS OPERANDI SPECIFIC TO DIAMOND INDUSTRY

10.1 There are many ways in which taxes can be evaded as far as diamond industry is concerned, more prominent being lowering the yield of polished stone to rough diamond. As we have seen above, a rough normally goes through many processes before a stone is polished and final product ready to be consumed is made.

10.2 One more area where tax usually gets evaded is the quality of diamond being sold. Rate of diamond usually varies according to its properties.

10.3 Also as mentioned earlier, the different processes lead to loss in the weight of diamond. Also when a diamond is cut into different pieces normally the sides that are left after cutting a diamond into different shape leaves the sides unusable or rather not of a type a company usually manufactures and the said wastage, referred to as 'SD' is sold to other traders through brokers after 4PM after which no new diamond is taken into manufacturing process. These SD are usually sold in cash which leaves a scope for tax evasion.

10.4 It is essential for a diamond merchant to keep his man in the country from/ to, where rough diamonds are being imported/ exported, to keep a watch on international demand and supply position. The supply of rough diamonds is controlled by the Diamond Trading Company (DTC) to keep check on prices. The diamonds sold by theDTC through sight system are of better quality and there is always a huge demand in the open market for such diamonds. The sight holder sells entire or part of the diamonds purchased from sight in the open market, and earns profit on such transactions which are not recorded in regular books of accounts. Such profit is brought to India with the help of sister concerns having offices outside India. Therefore the transactions of a diamond merchant with his sister concerns require deep scrutiny. When these diamonds reach India, these are shown to be against the invoices from the DTC, but actual stock may not be of the quality shown in these invoices.

10.5 Another practice adopted by some of the diamond merchant is called 'dabba system'. In this, the exported polished diamonds are brought back to India through illegal channels. The purpose behind such practice is to inflate export turnover to get "export house" status, to get more credit facilities from the banks etc.,

10.6 When the rough diamonds are received at the head office, it is generally shown that these diamonds have been got manufactured into polished diamonds and then exported. However, often following manipulations are resorted to:

i. The entire stock of rough diamonds as such is sold in the local market and profits not disclosed in regular books of accounts. However, to fulfill the export obligations, the assessee may purchase polished diamonds from local market and export the same. He may export duplicate (synthetic) diamonds or may use "Dabba" method as mentioned above to fulfill the export obligations. Import licenses are given against the export turnover. These import licenses are transferable and there is always premium upon the same. The exporter may use the methods mentioned above for showing higher or bogus exports to obtain import licenses of higher value.

ii. The rough diamonds may be cut into polished diamonds, but sold either wholly or partly in the local market, without disclosing the profit earned on such sale in the regular books.

10.7 The role of commission agents is crucial for making purchases and sales in local market. At about 11.00 AM daily, the commission agents visit the office/ factory site of the diamond merchants. Depending upon the demand in the market and requirement of the diamond merchants, diamonds (rough and polished) are given to these commission agents for sale in local market. As usual, these diamonds are accompanied by the Jangad. These commission agents are given a price range between which they can sell against their commission at 1% of the sale consideration. Small transactions are generally made in cash, but for bigger transactions, credits ranging upto a maximum period of 120 days is generally given. At the end of the day, the unsold diamonds are returned by the commission agent with the jangad. Often such transactions are not recorded in regular books of accounts.

10.8 Another grey area in the diamond trade is the 'rejection'. There is no basis to determine or estimate it. It can range from 2–3% to 50% of the total rough diamonds imported. Therefore, generally assessee's show a higher rejection than the actual, and the production obtained from the inflated figure of rejection, is sold in the local market. In these transactions, the entire sale consideration is assessee's profit, as the assessee has already debited purchase value of such stock. Actually, it is a most common way of suppression of production. So where high value rough diamonds are purchased and still a higher rejection is being claimed, then the claim of assessee needs deep scrutiny.

10.9 Understatement of yield is another common method of suppression of production. As mentioned above, yield depends upon the quality and size of the rough diamonds. The average yield generally ranges between 25 to 40%. An understatement of yield by even 2 to 3% can make a big difference.

10.10 As mentioned above, there is a large floating stock in the market outside the books of accounts, due to inflation of 'rejection' and understatement of yield. Therefore the market requires some persons who can issue bills for sale of such diamonds. To obviate these difficulties, several persons have sprung in the market, who merely issue purchase bills by charging some commission, without any actual purchase/ sale transactions. Therefore the purchases shown from local market, require to be scrutinised critically. In the books of account of such billing

agents, who issue only bills, the purchases are generally shown in cash. In their bank accounts, the deposits are by cheque, which are the alleged sale proceeds of cut and polished diamonds, but immediately thereafter, there are cash withdrawals. The billing agent shows such cash, as "cash on hand" or payment to bogus parties against fake purchase.

10.11 In their own factories, the diamond merchants appoint managers to take care of overall work of manufacturing side. Generally these persons are relatives of the diamond merchants. A fixed salary is paid to these persons, but in the regular books of accounts, these persons are shown as job work contractors and payments to them are shown as job charges paid through a/c payee cheques. Their bank accounts are operated by the accountant of the diamond merchant. For this, signature on blank cheques are obtained in advance and cheque books of all such bank accounts, documents relating to Income-tax returns etc. are kept in the possession of a trusted person of the diamond merchant.

10.12 As mentioned above, the head offices of most of the diamond merchants are at Mumbai, and factories are at other cities/ towns. So, to make payment of job charges to craftsmen and to meet factory expenses, cash is sent by head office, mostly through 'angadias'. On receipt of cash from the head office, the labourers are paid in cash. Such payments, in cash, to labourers or job work contractors are not shown in the regular books of accounts. These are shown in regular books, only when the head office sends bank drafts. The bank drafts are deposited in the bank account, and simultaneously cheques are prepared in the names of job work contractors. Such cheques are deposited in the bank account of the job contractors and cash is withdrawn from their bank account. Cash so withdrawn, is again sent to the head office, through the 'angadias'. The accountant of the assessee maintains a rough cash book showing such movement of cash from head office to factory office, and vice versa.

10.13 In the Diamond Industry, for all practical purposes, the accounts are maintained on Samvat year basis, though for purposes of Income-tax, these are shown from 1st April to 31st March. In the months preceding Diwali, purchase of rough diamonds and production increase substantially. Diamond merchants know that since for next one month, there will be no production, so they build up the stock for that period. So they work in double shifts for about two months prior to Diwali. Therefore, August to October is a hectic period in diamond industry.

10.14 The unaccounted income earned is generally invested in diamond stock itself, either in rough or in polished form. Another avenue of unaccounted investment is the factory buildings and machinery used for diamond manufacturing. Nowadays laser machines are of high value. Residential buildings, jewellery, farm houses are the other items where unaccounted income is invested. Unexplained expenditure is also incurred on household expenditure, marriage ceremonies of family members, and on donations for socio/ religious purposes, etc.

10.15 In the diamond trade there are a number of variables which limit the possibility of proper investigation by an Assessing Officer. Some of these are:

a. There is no check on the disclosed yield/ rejection.

b. Valuation of closing stock is not verifiable.

Since the nature of trade is such that evidence of correct amount of yield, rejection, etc., is unlikely to come on record in the normal course, surveys are required in suitable cases. If job

worker is used for cutting or polishing then there is always a possibility of understating yield of cut and polished diamonds, or of showing inferior quality diamonds. The diamond exporter is likely to be cheated by job contractor or craftsman unless he has his own manufacturing facilities and rigid checks. Therefore, these exporters follow a peculiar modus operandi to protect their business interest. The exporter sells rough imported diamonds directly in open market in cash. There are many craftsmen who have their own cutting and polishing machines. Such persons purchase rough diamonds and cut and polish these on their own machines and in turn, they sell polished diamonds in open market. The importer of rough diamonds who is under obligation to export polished diamond, purchases such cut and polished diamond from open market and then exports them. Thus an exporter will show in his books import of rough diamonds, and payments to labour charges to various contractors, but in reality there will not be any payment of labour charge. However, the books will show payments of labour charges by account payee cheques and the cheque receipt in their returns. It is established that labour charges are bogus. The real fact is that, the exporter makes profit on sale of rough diamonds as also on the export of the cut and polished diamonds purchased from the market. Many exporters also utilise cash sale proceeds of rough diamond in other business like finance. The entire profit on these cash transactions remains outside books of account. The Assessing Officer cannot find out or make any addition on these items from the books of accounts. The only way to investigate such cases, is to undertake surveys under Section 133A at the main office as well as at the factory sites and branch offices.

10.15.1 While conducting survey, stock register, jangad file, purchase and sale bill file should be immediately called and examined. The stock register is normally maintained in three parts-Stock of rough diamonds, Stock of rejected diamonds, Stock of cut and polished diamonds

10.15.2 Before commencing the survey, the assessee should be asked to work out the stock of rough diamonds, rejection and cut and polished diamonds separately as per stock register, by including jangads, sale and purchase bills. The stock of rough diamonds, rejections and cut and polished diamonds should be obtained separately weight wise and not value wise. It is necessary to get the assessee committed on the stock of rough diamonds and rejections separately, because, the value of rejection per carat may be Rs 100/- per carat while rough diamonds may cost about Rs 1000/- and more per carat. Therefore, often assessees take stock of rejection as well as rough diamond together so as to explain away the stock of rough diamond or to show higher quantity of rejection, whose value is nominal.

10.15.3 But there are always chances of finding loose papers at branch offices, giving details of purchases of cut & polished and sale of rough diamonds, which are not recorded anywhere in regular books of account. Thus in branch offices, there is a possibility to get evidences relating to cash purchase of cut and polished diamonds, cash sale of rough diamonds, unaccounted stock of polished diamonds, and evidence relating to stock lying with broker.

10.15.4 Since the entire cash transactions are outside the books of account, the concealed income can be determined on the basis of excess stock, cash purchases, cash sales, etc. The unaccounted stock is normally kept at the branch office, or in bank lockers.

10.15.5 The transactions recorded on loose papers are usually in coded language and are in

thousands. For example, sale of rough diamonds on credit is normally recorded in loose paper like this:

Table 1

Fancy	(Name of Broker)
20.02.92	(Date of issue)
90 Fix	(Payment to be received within 90 days)
2000.39	(Carat)
5.31	(Rate per carat decimal to be ignored) (Rough diamond)
10622.07	(Total consideration Rs 10,62,207/-)

Such transactions recorded in loose papers may have to be decoded.

10.15.5.1 In this trade, in a majority of cases the stock is valued at cost. However, the working of the cost price poses a difficult problem for the assessee as well as for the department. The department does not have means for physical verification, both quality and quantity-wise, and valuation of closing stock is more or less a question of estimate. The valuation of closing stock will have to be considered in the light of the recovery position as well as the gross profit rate of a particular year. Another point that has to be kept in mind is that the closing stock may comprise of stock lying with the trader himself, stock with brokers and other traders given on consignment basis and stock lying abroad. For valuation of the closing stock lying abroad, one of the methods adopted by the department may be called" Export invoice value method". First the export invoice value of the closing stock lying abroad is ascertained. This value is then reduced by a certain percentage to arrive at cost price. This method presupposes that value of a particular item as given in the export invoice includes the profit margin because the said export invoice value represents the sale price. This percentage which is reduced from invoice value is generally determined on the basis of the gross profit rate of the assessee in the past and the year under consideration.

10.15.5.2 The value of a rough diamond depends upon the quality of the stone, shape, cleavage etc. The type of cut used is meant to enhance the glitter and luster of a diamond. The experts assume that on an average, gem's value appreciates at 15% per annum.

10.15.5.3 Another issue that arises before the Assessing Officer in respect of non-realization and non-repatriation either partly or fully, of the export proceeds to India is that if the exporter is an assessee, he is bound to claim deduction of the so-called irrecoverable amount as bad debt. During the course of the assessment proceedings in support of his claim, he may produce some correspondence which has been arranged or stage-managed by him in connivance with his foreign counterpart and or with some other persons abroad. It is pertinent for the Assessing Officer to check up the position with Reserve Bank of India, FT &TR as also Enforcement Directorate. He might possibly get sufficient documentary evidence to justify the disallowance of the bad debt claim.

10.15.5.4 Experience has shown that collusion of Indian importer or exporter with his foreign counterpart is common. In cases where some intelligence or piece of information about under-invoicing of exports has trickled down from the Reserve Bank of India, the Customs House or where the Assessing Officer has some hunch during investigations, he must go deep into the entire gamut of purchases and sales in respect of the goods exported or imported. The Assessing Officer should also closely see the rates referred to in the contract cable and contract memo. The contract between the foreign importer and Indian exports is usually made through e-mail and is followed by contract memo, the latter being the

confirmation. The rates can be compared with the prevailing market rates. In such cases, the only method of detection is to follow up the origin of goods exported and to verify as to whether description as per invoice is correct.

10.15.5.5 Details of exporter's foreign tours may be obtained from RBI to ascertain that his probable expenses abroad are fully accounted by foreign exchange released to him by the Government. A large number of cases have come to notice of the Enforcement Directorate and the RBI, where exporters overstayed abroad or spent much more foreign exchange than what was sanctioned to them. This will imply that such persons might be hoarding foreign exchange reserves abroad and warrant intensive enquiries about invoice manipulations.

10.15.5.6 More important from Income-tax point of view and more widespread is the phenomenon of booking bogus income through exports. Some thumb rules may be used for carrying out the basic checks to decide whether to proceed further in the matter or not:

i. Whether this is the isolated case of export by the assessee in past several years?

ii. Whether the assessee has shown reasonable rates of purchases and sales?

iii. Whether the assessee has opened any accounts abroad or whether the money has been repatriated immediately?

iv. Whether the assessee has booked the export directly or through some broker and a broker is involved then what is his reputation?

v. Whether the assessee looking to his background, can genuinely export any articles or not?

11. LEGAL

11.1 One area which is legally tenable but leads to huge revenue loss is "round tripping" of consignment in diamond industry. This is perhaps also the reason of huge NPA in bank loans.

11.2 The practice where some traders export the same stock of polished diamonds multiple times to borrow from banks against the receivables at a lower interest rate than what is available through traditional money-lenders and to park the profits at lower tax countries like UAE, Belgium, Hongkong etc. and import the same consignment at higher rates. For example in STAGE 1 Company X applies for pre-shipment credit for three months from a bank to get a working capital of say $50 million to import rough diamonds from Belgium and pay for labour charges and other expenses.

11.2.1 Company X than cuts and polishes the diamonds and exports them for a value of say $52 million to company Y, either in Dubai, Hong Kong or US. This foreign firm is usually owned by a relative or cartel associated with company X itself. The company X books profit of say $2 million in India on said consignment and pays tax on said profit.

11.2.2 The same consignment is again imported at higher price of say $60 million. This transaction benefits the company X in 2 ways. One, the purchase price of same diamond in its hands has already been inflated and the profit on said transaction parked at lower tax countries and another company X can avail credit facility on its import consignment of a value of $ 60 million. The same consignment is then again exported at say $61 million which say is its actual price. So what happens here is company has paid a tax on only $3 million in India and majority of the tax is parked outside the country.

11.2.3 The AO should acquaint himself with the various accounting software available in the market for the specific industry. The various

softwares being used in the industry are as follows:

i. Reach Accountant.
ii. Tally.
iii. Quick Books.
iv. Profit Books.
v. Marg.
vi. Jainam.

11.3 The softwares mentioned above create logs and also keep the details of the process that the rough diamond had undergone. Hence the use of computer to detect the respective losses in each department can give an estimate of yield of processed diamond and the same can be compared with actual yield to detect abnormal difference. Normally an AO can head straight to polish department and take stock of all the outwards from the polish department and tally the same with the computer software for inwards from all the departments. This can give an idea if any unaccounted diamond has crept into the polish department bypassing all the above departments.

11.4 Generally diamond is a very complex industry and the trade is usually carried on in a very secretive manner. It is very difficult to investigate any areas of tax evasion without having proper knowledge of the industry and its methods. However in recent times the use of computer has made it somewhat possible to investigate.

CHAPTER

11

Beauty Parlours and Fitness Centres

BEAUTY PARLOURS

1. INTRODUCTION

1.1 This new trend of beauty parlours and fitness Centres has spawned a new and fast growing service industry that caters today's new culture and generation. Today most youth and even the not so young dream of being handsome and beautiful and possessing the ideal figure. This growing consciousness has resulted in the growth and spread of beauty parlours and fitness centres. In order to be able to give the above-mentioned services, a modern beauty parlour requires sophisticated furniture and fixtures.

1.2 Besides small tools, consumables like creams, dyes, perming lotions, styling products, astringents, cleaners, colouring materials, cosmetics and shampoos are used. Some of these products are also imported. In order to assess the business conducted by a particular parlour, it would be worthwhile to note the amount of consumables used.

1.3 Many beauty parlours have in recent years expanded their scope of business by banking on their trade names and creating franchisees. Thus the top names in the business such as Jawed Habib, Shahnaz Hussain, Vandana Luthra, etc. have expanded rapidly in recent years. The franchisees are required to pay a certain fixed fee to the masseurs. The parent company also makes money from the retailing of its products as also charges certain franchisee fee from these outlets for the use of its trademark.

TAX INVESTIGATIONS

2. SUPPRESSION OF RECEIPTS

2.1 Studies of some of the files of beauty parlours have revealed that many of them do not disclose their entire business income. Much of the cash receipts may be suppressed which can easily be unearthed in a survey action. The fee received from the franchisees is often not recorded. Further, in case of companies/ firms giving training courses, the total number of students is also often suppressed. It has been noted in a few cases that the number of certificates given at the end of the course exceeded the number of students shown on the registers. The Assessing Officers should be on the alert for these possibilities.

2.2 Wrong Claim of Deductions: Wrong claims are a high possibility in this line. A beauty parlour concern had claimed deduction under Section 80-I in respect of profits and gains from an industrial undertaking. On investigation it was found that the said income was not from any industrial undertaking. Further, the said company had made a false claim of exporting herbal products when the products did not have any herbal content. In that case the detection led to successful prosecution.

2.3 Claim of Bogus Expenses: The main sources of income of these companies are receipts from clients, franchisee fees, diplomas fee receipts and miscellaneous income. The major items of expenditure are salary and wages, commission paid, consultation charges, tours and travelling, diploma expenses, sales promotion expenses and repairs and maintenance. It was noticed that the commission paid especially in the bigger cases are always in lakhs of rupees. In certain cases it was found that this commission is paid to close relatives and friends of the Managing Directors of the Company. The invocation of the provisions of Section 40(A)(2)(b) could be considered in cases where AOs find that commission is being paid for no services or in order to bring down the taxable income of the assessee. Similarly, in such a business, a certain amount of sales promotion is inevitable. However sometimes, certain payments which cannot be accounted for are included under the head 'sales promotion". Finally, these parlours have arrangements with physicians, dermatologists, and cosmetic surgeons, who are on the panel of these parlours for specialized services. Often when members are sent to these consultants, there is a certain income "kickback or referral charges", which is not accounted for by the parlours.

2.4 Cross Verification from Suppliers and Franchise Agreements: Beauty parlour business is an unorganised sector and mostly done under proprietary name. It is difficult to map the footfall of clients; however some basic check can make some more data available for further enquiry like,

a. The cosmetic material is procured from branded companies like Loreal, Lakme, etc. A list of material supplied by them, through their distributor, can be obtained which will give an idea of order raised and average consumption by end user.

b. Where the business is carried under Franchise Agreement, the royalty Clause, whether fixed royalty or% of Sale, will give an idea of income and expenditure.

2.5 In the case of beauty parlours, on special occasions, the personnel of the parlour would be called to the house of the client. In such cases, there are some extra charges, and it has been found that these charges were not accounted for.

FITNESS CENTRES

3. INTRODUCTION

In today's world, beauty is concomitant with a well-maintained physique. Therefore, many of the successful beauty parlours have extended themselves into fitness centres, which not only deal with cosmetic and beauty solutions, but total body care. Fitness centres have now sprung up in major cities of the country, where people believe in maintaining a trim figure and have sufficient income to be able to visit these centres.

4. FEATURES OF MODERN GYMNASIUM

4.1 Unlike the old 'akhadas' or bodybuilding centres, the modern gymnasiums are situated in elite or residential localities. They offer a comfortable ambience. They are equipped with the latest machines. Most of them are air-conditioned. This allows the members to work out in comfort. Exercises are done under the supervision of a trained physical instructor, who has detailed schedules based on the members' physical conditions. The members have their

individual lockers for which they have to make extra payment. Further, these fitness centres have a central music system and the higher end ones usually have showering rooms, massage room and steam/ sauna rooms.

4.2 The floor space of a typical fitness centre is around 1500–2000 square feet, with a separate reception area, separate changing rooms for men and women, locker rooms, sauna and baths, and toilets. The types of machines available are the following-Treadmills, Bike, Stepper, and Free Weight Benches and Weights. In more popular centres, there would be two or more of each of these machines, to cater to the needs of the members.

5. ACTIVITIES

5.1 The typical activity of the fitness centre consists of a controlled exercise. In the beginning, the members are put through a step-by-step exercise program–stationary stepper, stationary bike, later the participant uses the treadmills, free weight benches and then graduates onto weights to build and tone the muscles. Expert advice from nutrition is also given as also the members are offered a plan of diet. For those who so require, dietary supplements and tonics are prescribed. Several of these centres sell these items and these are usually displayed at the centre.

5.2 The service offered by the fitness centres is generally the following:

a. Muscle toning and strengthening program.
b. Free weight program.
c. Cardiovascular conditioning programs.
d. Nutritional & bodybuilding supplements available.
e. Fitness, nutrition & healthy lifestyle.

6. FEES PAYABLE

The normal scale of fees of a typical fitness centre is as below,

In cases of elite fitness centres, the rates would be higher. AOs would do well to call for a schedule of the current rates, since the rates are subject to change without notice. The charges are payable in advance, and are applicable for the period for which they are charged. Generally, no refund of fees is permitted. Certain centres charge admission fee, which sometimes is not accounted for.

7. SPAS AND HEALTH CENTRES

7.1 The emphasis on good health and treatment especially for the rich, have resulted in the opening of several health resorts especially in tourist regions such as Goa, Kerala or Karnataka. Several health centres especially in Kerala have developed the art of Ayurvedic massages. Tourists spend weeks at these resorts, which are both recreational as well as therapeutic in nature. Several Resorts have come up in Goa and Kerala that provide a total weight loss or diet control sessions, the period depending upon the client. Many of these resorts are highly priced. Membership, both individual and corporate, is offered by many of these resorts.

7.2 The charge of some of these programs is often flexible. At certain weight loss programs, charges increase in proportion to the weight lost. Some payments made by the members of these spas and treatment centres, are in cash, since much of this money is generally not accounted for. Since these spas are generally on the lines of the five star hotels, much of their rates for services are similarly priced. A client could spend upto Rs. 50,000 for the duration of a fortnight at these locations. Some of the high end SPA centres charge upto Rs.10,000/- for 90 min session.

TAX INVESTIGATIONS

8. INITIAL INVESTMENT

8.1 Most of the beauty parlours, fitness centres or health resorts, require major investment especially in the initial phases. While the majority

of these could be financed with bank loans, the promoters would be required to put in certain margin money. This would necessarily have to be provided by the entrepreneur or his close associates. Huge amount is spent in furnishing of interiors, and it is likely that in several cases, much of this amount is in cash provided by promoters and not accounted for.

8.2 Verification of Registers and Charges: Each of these centres maintains a register of their members or clients. This should be invariably called for, together with the schedule of charges. In several cases it was found that some of the members were not entered in the register or certain charges from the members were not accounted for.

8.3 Suppression of Receipts: Certain specialized treatments especially in the case of skin, or weight reduction or surgical cosmetic treatment require consultation with specialists. The client makes these charges to the parlour that in turn reimburses the specialist. It has been noted that some of these charges were not accounted for.

8.4 As most of the payments made to these centres are in cash since many of the clients use their unaccounted money for such services, certain portions of these payments generally go unrecorded. Survey under Section 133A should be conducted in suitable cases in order to estimate the actual receipts of such places.

8.5 To know the exact footfall, type of memberships and list of membership can be verified for annual income. Also where personalized trainers are provided for, the payment sharing terms of such trainers and payment made, can be used to arrive at the turnover of the fitness centres. Various promotional offers availed by members can also be used as a starting point for finding out average income. All of these services are subject to GST. Hence, the receipts should be cross tallied with the GST returns.

9. CONCLUSION

The mushrooming of the beauty parlours, fitness centres and spa centres is due to the urge in current generation to look fit and beautiful. The availability of various relaxation therapies, awareness of various fitness programmes/ diet schedules coupled with the rise in financial strength of middle class has led to rapid growth of these businesses, most of the receipts of which are in cash. The GST component is also high, and hence, there is a double incentive not to record full receipts: saving on Income-tax and GST both. The AOs should therefore keep themselves aware of ongoing local market practices and rates for such services, which shall be extremely helpful in determining the correct income of such businesses.

CHAPTER

12

Detective & Security Agencies

1. INTRODUCTION

1.1 Security has been a prime necessity for human beings living in organized society, especially those who own property. The security business as an organized set of activities handled by trained professionals is relatively recent in India. Though the security business came to this country roughly around 1970, yet its growth in India as an organized and sophisticated industry managed by modern highly trained professionals took real roots in the 1990s with the advent of economic liberalization and the globalization of its business and society.

1.2 With time, the features of security agencies as on today have changed considerably. Most of the agencies in operation now are primarily engaged in providing physical security to multistoried buildings, colonies of cooperative housing societies, private bungalows in plush localities, farm houses, institutional premises, etc. These operations are ordinarily manpower-intensive where predominantly unarmed watchmen guard the external physical environments of the premises in question. Such watchmen are deployed from the vast pool of semiliterate and migrant job seeking men from remote parts of the country. The growing crime graph in modern day society coupled with the increasing failure of the authorities to provide adequate protection has contributed to the rising insecurity of the urban middle class forcing them to look for alternative security at affordable cost.

1.3 There are a number of agencies operating in various parts of the country having turnover in excess of Rs. 50 crore annually from their group operations which, for a service industry, can be considered as sizable. This business being a thoroughly tech-savvy one, vital information on the operations of the agencies can be accessed from their respective web sites. These are some of the leading agencies:

a. Globe Detectives Group
b. Sentinel Security Services
c. Premier Securities Group
d. Lancers Security Services
e. Eagle Hunters
f. Industrial Personnel Security Services
g. Ace Detectives India
h. TOPS Detectives & Security Services
i. BIS Group

j. Property Guards Security Services

k. Brinks Arya Security

2. INDUSTRY FEATURES

2.1 The agencies dealing in this business are broadly of two types-*one* that provides predominantly cheap guarding services to the middle class business and residential premises, and *the other* which offers a sophisticated security package that includes state of the art surveillance technology with security cover to lives and property against a variety of threats. The former mostly employs untrained and unarmed manpower whereas the later engages highly professional, trained and multi-skilled employees and possess latest techniques of the trade invariably obtained through foreign collaboration.

2.2 Most people associate security agencies with the activities concerning guarding of premises generally to control access and egress there to. A typical high profile security agency, however, offers a wide range of services:

a. **Industrial/ Corporate Guarding Services:** Covers securing the premises by armed/ unarmed security squads to combat labour agitation, strikes, lockouts, gheraos and other threats of physical violence to management.

b. **Data Security**: Provision to secure vital business and personal data through specially developed security software.

c. **Security Gadgets**: Providing all kinds of security equipment including close circuit television monitoring, intrusion and fire detection systems, gate automation systems, metal & explosive detection system, anti-bomb blast film, bullet proof vests/ jackets, night vision equipment, perimeter detection system, glass break alarms, etc.

d. **Fire-fighting Services**: Providing complete range of fire detection/ extinguishing solutions, fire risk analysis, and fire evacuation drills.

e. **Security Audits:** Providing the highly sophisticated service of security audits that involve the planned integration of guarding services with positioning of gadgets so as to achieve high level of security without intruding into the privacy of the workforce or the clients, something which is vital to various service industries.

f. **Dog Squads**: Providing specially trained breed of dogs for tracing, guarding, and patrolling activities.

g. **Escort Services:** providing armed/ unarmed escort for protection and security to individuals as well as goods of industrial and corporate houses.

h. **Loss Analysis**: Providing true indications of loss to business/ industry through monitoring possible employee theft, general pilferage, system loss, etc.

i. **Cash Handling/ Cash in Transit**: Providing the movement of cash to and from banks and ATMs which has become a highly lucrative and specialized assignment.

j. **Event Security**: Providing special security arrangements for events such as marriage parties, sporting occasions, public performances, beauty contests, public auctions, etc.

k. **Vehicle Security:** installing antitheft devices and tracking devices to secure not only vehicles but also theft from the vehicles.

l. **Global Investigation and Assignments:** providing a complete business and financial information and solutions across the globe including information on the business and the political scenario, global shadowing and the location of overseas assets/ properties.

3. DETECTIVE SERVICES

Besides the above, the more organized agencies offer various detective services which involve discreet sleuthing activities to suit either

individual or business needs. The following are the more prevalent services:

a. Employment screening.
b. Employee shadowing and surveillance.
c. Risk analysis.
d. Debugging of telephones and premises.
e. Financial credibility and expertise check.
f. Identifying and locating witnesses.
g. Developing evidence to substantiate allegation.
h. Planting stooges in labour union.
i. Undercover investigation against employee theft and sabotage.
j. Asset verification.
k. Verification of property deals.
l. Pre and post marital verifications.
m. Miscellaneous personal investigation.

4. SOURCES OF INFORMATION

4.1 The security business is highly flexible in its operational nature and there is no central regulatory authority to monitor its activities. The Assessing Officer has to gather information from a variety of sources to better comprehend the business operations. Some sources and the nature of information available with them are listed hereunder:

a. **Labour Commissioner**: Information on the number of employees under the Minimum Wages Act.
b. **Provident Fund Authority**: Periodic returns furnished by the agency to comply with the EPF and RPF Act.
c. **ESI Authority**: Information on the number of employees covered and contributions made under the ESI scheme.
d. **Labour Department:** Information governed under the Industrial Disputes Act and the Workman Compensation Act.
e. **GST Authorities**: The important information available from the periodic returns of GST paid by the agency.
f. **Department of Telecommunications**: Information pertaining to the use of wireless network by the agency.
g. **Shops and Establishment Act Authorities:** Certificate of registration of establishment relevant to agencies operating in Mumbai.
h. Security Guard Board Act of Greater Bombay, 1981 administered by the Labour Department of Maharashtra requires a set of statutory information to be filed by every agency.
i. Maharashtra Exempted Security Guards Association based in Mumbai.
j. Data Recovery Centres, Pune/ SEBI.

4.2 Besides the above, important information on the trade can be found from the security literature including the monthly news bulletin *'World Association of Detectives'* published from New York and the *'Security'* Magazine published from London. There is also an important annual event organized in India in the form of a trade fair organized by the security business at Pragati Maidan, New Delhi, usually every December where the latest trends and wares in the business are showcased. One important source of information on the bigger and more important ones among the agencies is the Internet. A number of agencies, particularly the ones engaged in multiple centres, have their web sites which can be accessed for a host of information. Such web sites can be accessed through any popular search engine by putting a general search on "security business" or "security business in India".

5. BOOKS OF ACCOUNTS AND OTHER RECORDS

5.1 Following basic records are maintained by all agencies:

a. Cash book.
b. General ledger.
c. Bank book.
d. Journal book.
e. Stock register.
f. GST returns.
g. Salary register.
h. Attendance rolls of employees.
i. KYC details of each employee.

6. TAX INVESTIGATIONS

6.1 Transactions out of Books

In order to understand the possible methods of tax evasion involved, it is important to understand the business operations of the agency and the profile of its clients. Before undertaking a scrutiny, the Assessing Officer should closely review the services rendered to the clients with a view to pinpointing areas where manipulation would be possible. Once such areas are identified, the income and expenditure components involved should be meticulously examined to ascertain the reasonable balance between the two.

6.1.1 Splitting of Income

The income components of the agency shown on books generally consist of receipt against professional services rendered and receipt against goods (generally security gadgets and equipment) sold. At times, depending on the contract made, the services rendered component also incorporate gadgets installed and used by the agency. In such cases the agency often shows utilization of gadgets either manufactured by itself or procured by it from a group concern or outside. In either case, the cost of gadgets tends to be exaggerated so as to reduce profit on the transaction. This practice is likely to become more popular in the future in order to minimize the impact of GST on the business. It is, therefore, necessary that the GST records of the agency are carefully examined to unravel the machinations used for reducing income.

6.1.2 Related Party Transactions

The use of a manufacturing unit to manipulate profit is a common practice amongst the leading agencies in the country. In most cases, it can be seen that the bigger agencies operate their own units to manufacture security equipment for utilization in client service. Mostly, these manufacturing units are maintained far outside the principal place of business where tax returns are filed (for example, XYZ Ltd does most of its business and files its returns in New Delhi whereas its manufacturing unit is located in Bangalore) and such unit conveniently runs into a sizable loss to offset the profit earned from services rendered. Sometimes, when the manufacturing activities are conducted by a separate group company, the equipment are acquired by the agency at a very high cost from the sister company to push the overall profit on services rendered down to the minimum. It is, therefore, necessary to scrutinize the manufacturing account carefully and, wherever the sales are primarily to the group company, it is important to examine the equipment component utilised by the agency *vis-a-vis* the rates in open market.

6.1.3 Cross Verification of GST Return and other Documents

The services component of the income can be counter checked from two important references, (i) GST returns and (ii) tax deduction certificates. Appropriate legislation has made it obligatory for the agencies to make periodic payment and submission of GST returns. These records could be tapped for cross-verification of service receipts of the agency. The other important record is the tax deduction certificate, the scrutiny of which would indicate receipts of agencies against service contracts. It is not uncommon to find that a few assessee fail to disclose receipts against their income column whereas they proceed to lodge Tax Deduction Certificates to claim credit of tax payment.

6.2 Inflation of Expenses

Most agencies earn income by rendering predominantly guarding services. Most of these

services are provided by unarmed guards deployed by agencies with nothing more than a set of uniform and an identify card issued by the agency. The deployment of armed guards requires a valid gun license in the name of the guard which very few in the country possess. It is common knowledge that the agencies whose primary income constitute receipt against guarding services have to incur a few items of expenses which include salaries/ wages to the guards, certain amount of allowances, cost of uniforms, salary and expenses of supervisory staff, and usual establishment expenditure. Owing to the large scale availability of unemployed migrants from the countryside, the agencies command favourable market in respect of availability of low cost manpower. Since the rural migrants have very little bargaining power, they are hired by the agencies not only at a very low cost but also exploited in terms of having to deliver more hours of work than required as per labour laws. In this context, it is usually found that the agencies find it very easy to manipulate the main input that is required for their operation in form of watchmen. The agencies involved may not only inflate the expenditure incurred on the watchmen but also may likely inflate their number as well. Here, a meticulous examination of the muster roll, duty slips, and supervisors' reports would help in pinning down the assessee.

6.2.1 Inflation of Salary/ Wage Expenses

Investigation by the Department in a few cases revealed that the watchmen at the time of their recruitment are generally made to sign a number of blank receipts against their salary/ wages which are utilised by the management to fill in a much higher amount than what is actually given in cash to them. Thus, the owners for their own use retain a large amount of cash withdrawn for making various payments including salaries/ wages. A thorough scrutiny of such expenditure is, therefore, warranted to arrive at the true income of the agency. A good pointer in this direction is the study of various web sites offered by security agencies which contain information on the hiring charges of armed as well as unarmed guards. Quotations of rival local agencies would also indicate comparative charge in this regard. Such comparison would provide a fair indication on the veracity of the expenses claimed on account of salaries/ wages.

6.2.2 Excessive Claim of Other Expenses

Other areas of major expenses are cost of uniforms to guards, various welfare expenses debited on account of staff including conveyance and food expenses. Enquiries conducted by the Department in recent past reveal that such claims of welfare expenses on security personnel is merely an eyewash and the expenditure stated to be incurred in cash are more often than not pocketed by the management. The Assessing Officer should adopt suitable devices to scrutinize such claims effectively.

6.3 Forfeiture of Deposits from Security Personnel

In some cases, it has been found that the agencies reportedly deduct certain amount from the staff on account of security deposit against uniform and other items supplied. These are shown on the books as liabilities to be refunded to the staff subject to conditions. However, the conditions prescribed are such that these men get very rarely refunded as most of them either leave their employment abruptly or the security amount is appropriated for breach of the stringent conditions attached. But the liability is seldom written back as income. This should be kept in mind at the time of scrutiny and questions regarding the treatment of the security deposit of such personnel should invariably be put.

6.4 Examination of Bank Accounts

An effective scrutiny of the bank accounts maintained by the agency is the key to unravel the extent of manipulation of income. It is often seen that the inflation of expenses and claim of bogus expenses mostly depend on manipulation of bank accounts by the agencies. The common practice in the business is to withdraw large amounts of cash from banks to meet various expenses. *At times expenses are made by issue of*

large number of self-cheques which are converted to cash and collected back by the management. It is, therefore necessary that a thorough enquiry of the bank accounts maintained by the management disclosed on books of account should be conducted along with the accounts maintained in individual names including in the names of close confidantes and family members. It is not uncommon for cheques to be encashed out of agency account only to generate cash to be deposited in the accounts of individuals/ family members as well as accounts not disclosed to the Department. All instances of large cash withdrawals and issue of self-cheques should be thoroughly examined to establish the utilization of cash by linking the same to respective bills, vouchers etc.

It would be important to keep in mind that in today's business world most financial transactions including the fraudulent ones are routed through banks some way or the other. All serious investigation into the banking transactions of the security business should use the points made at great length in Chapters 15 of Volume I of the Techniques of the Investigation Manual.

6.5 Unaccounted Investment in Properties

Very often the surplus out of large cash withdrawals pocketed by the management is ploughed back for acquisition of immovable assets like real estate where it is easier to park unaccounted cash. It would be worthwhile to locate any transaction in real estate either in the names of the owners or their family members which would help in establishing a nexus towards claiming bogus expenses. Similarly, large cash withdrawals can be connected to conspicuous consumption including expenses incurred in functions, house furnishings, foreign travels, etc.

6.6 Undisclosed Cash Receipts

The nature of certain operations of the agency, especially if it undertakes detective work, involves a fair chance of charges received in cash. Assignments like pre-marriage background verification, post-marital sleuthing on behalf of one or the other spouse, keeping track of rich parents' children, spying on business/ professional rival to name a few cover a high likelihood of cash payments. However, these areas are not at all easy to investigate effectively. Again, one has to carefully go through the large cash withdrawals of the agency to decipher any thread leading in these directions. In the cases of agencies known for its sleuthing abilities, the movements of the major operatives should be carefully examined to connect the same to commensurate credit of receipt. One area to tap in such cases could be the travel agent of the agency and others who provide logistic support for covert and overt operations. The transcripts of calls made on cell phones could provide vital clues in this regard. Number of hours spend by each employee and number of outside hours may be verified case wise so as to get fair idea of Receipts taken.

6.7 Hawala Transactions

Because of the multiplicity of operational bank accounts, often in various cities, these agencies, at times, may carry out hawala transactions. Bank transactions, especially large deposits and withdrawals from different branches on the same day may be carefully scrutinized in this regard.

7. CONCLUSION

According to a recent market research conducted by the 'Security' magazine, computer security has emerged as the area of most increasing concern among security practitioners. High profile security agencies have been associated with management of mega events. The outlook for this business has improved tremendously after 11 September 2001, the day the WTC twin towers fell in New York and the world got irretrievably pushed into insecurity. Now, practically every business and every individual who can afford it goes running to acquire a security cover. The prospect for this business looks astonishingly bright. The AOs everywhere would do well to keep a close eye on this rising industry and keep themselves abreast of the latest trends and they should also gain awareness of Information Technology Act.

CHAPTER 13

Sports Goods Industry

1. INTRODUCTION

1.1 The Sports Goods Industry was founded by Sardar Bahadur, Sardar Ganda Singh Oberoi in the year 1883 at Sialkot and Sports Equipment became the first Indian Industrial Product to be exported in 1885. The Sports Goods Sector consists of both organised and unorganized Sections of the industry. The Indian Sports Goods Industry thus has its origins in Sialkot, Pakistan. When India got partitioned in 1947, many Hindu artisans migrated from Sialkot to Punjab and Uttar Pradesh in India. Jalandhar is the most primary centre of India's Sports Goods Industry followed by Meerut in UP and Gurgaon in Haryana.

1.2 India is one of the largest producers of footballs and other inflated balls. The Indian Sports Goods Industry has grown tremendously since 1947. Some of the products like Cricket bat, ball, football and nets have been steadily gaining fame all over the world. The Sports Goods Industry has grown by leaps and bounds in the past five decades and has contributed significantly to the Indian Economy by way of generating employment, exploiting the rural and urban potential and also by way of exports, which are increasing every year.

1.3 The Indian sports goods industry manufactures more than 300 items. United Kingdom is one of the major importers of sports goods manufactured in India followed by countries like USA, Germany, France and Australia. Some of the major items that are exported include inflatable balls, hockey sticks and balls, cricket bats and balls, boxing equipment, fishing equipment, indoor games like Carom and Chess boards and some protective items.

1.4 Currently, the industry is mainly focused in the small-scale and cottage sector backed by some of the government's liberalized industrial policies. There is also a wide scope for improving the marketing of products and modernizing the technology used for manufacturing them. Some of the major centres of the sports manufacturing industry are briefly as under.

2. JALANDHAR

Jalandhar is an important supplier of quality sports goods to more than 130 countries

including some of the developed nations of the world. Jalandhar is the only place to introduce the concept of machine-stitched footballs to meet the demands of the FIFA world cup 2010 and beyond.

2.1 Skilled workers engaged in this industry are the most important elements in the production. The official estimate of the total number of persons working in the industry is about 1,70,000 while the unofficial estimate is 3,00,000.

3. MEERUT

There are about 1250 registered and 2000 unregistered big and small sports goods manufacturing units providing direct and indirect employment to approximately 70,000 persons in the Meerut District of Uttar Pradesh. The production is low because the units are not mechanized as only 20% of them use machinery. Also, latest technology is not available which acts as a deterrent in respect of the competition from China, Pakistan, etc. About 60% of total production is being exported to Australia, South Africa, England, America, West-Indies, New Zealand, Zimbabwe, Bangladesh etc., through middle men and the remaining products are sold in the domestic market across India.

4. KASHMIR

The history of cricket bat industry in Kashmir goes back to pre-partition days when Sialkot (Pakistan) was the sports goods centre. With the partition of the Indian sub-continent, the skilled craftsmen of Sialkot shifted to Jalandhar, Meerut and the cleft makers of Kashmir turned toward newly established centres. In due course of time, the demand of the cricket bats in the country increased and cricket bats started being manufactured to meet this demand. The finest willow is English Willow, followed by Kashmir Willow for manufacturing cricket bats. Over 80% of all cricket bats today are manufactured in Jalandhar, Meerut, Kashmir and Jammu cities. All of them depend on Kashmir for their willow clefts.

5. AS PER HTTPS://WWW.IBEF.ORG/ EXPORTS/ SPORTS-INDUSTRY-INDIA. ASPX,THE DOMESTIC INDUSTRY EXPORTS NEARLY 60 PER CENT OF ITS TOTAL OUTPUT

5.1 Total sports goods exports for 2017–18 stood at US$ 232.80 million, as compared to US$ 224.83 million during the previous year. Between Apr-Oct 2018, they have reached US$ 193.20 million.

5.2 Top ten destinations for export of Sports Goods between Apr–Oct 2018 were the US, UAE, UK, Australia, Germany, Netherlands, France, South Africa, Sweden and Canada.

5.3 Major exported items were inflatable balls and accessories, nets, general exercise equipment, boxing equipments, toys and games, and protective equipment, cricket equipment, sportswear, carom boards and hammock. Indian sports products have been exported for global events. India has emerged as the leading international sourcing destination for inflatable balls and other sports goods for international brands such as Mitre, Lotto, Umbro and Wilson.

6. SPORTS GOODS EXPORT PROMOTION COUNCIL

6.1 The Sports Goods Export Promotion Council (SGEPC) promotes the export of sports goods and toys from India. SGEPC represents the leading 200 manufacturers and exporters of sports goods and toys in India. It also provides assistance to industries for expansion etc.

6.2 The sports industry can be broadly divided in two types; one is sports goods manufacturing industries and the other is sports apparels manufacturing industry. Sports goods manufacturing industries can be further categorized into two broad heads depending on basic raw material used.

a. Sports goods where wood is the basic raw material such as cricket bats, hockey, badminton racquet and tennis racquet

b. Sports goods where wood is not the basic raw material such as footballs, cricket balls and other accessories like gloves, pads etc.

7. MANUFACTURING PROCESS AND THE RAW MATERIAL REQUIRED

This industry is a labour intensive industry and skilled labour is a pre-requisite for manufacturing of quality products. There is not enough scope for automation in this line of business.

7.1 Cricket Bats

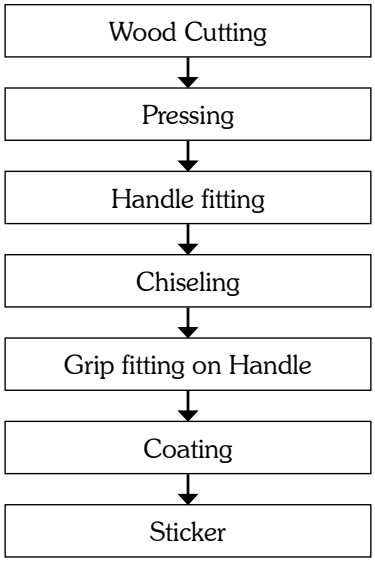
a. **Sizes**

1 no., 2 no., 3 no., 4 no., 5 no., 6 no., and 7 no.

b. **Raw Material:** The wood used for manufacturing cricket bats is of three types-the cost of the bat depends upon the type of wood:

1. **English Willow:** Soft wood imported from abroad.
2. **Kashmir Willow:** Soft wood comes from Kashmir Valley. Since interstate transfer of wood is banned in J&K, semi-finished product in the shape of cleft is purchased from J&K and after finishing these bats are sold in domestic and international market.
3. **Popular Wood:** This type of wood is available in the local market.
4. **Handles.**
5. **Grips.**

c. **Manufacturing Process Flow Chart**



7.1.1 The Process thus Involves

a. Selecting the Timber

i. Choosing mature trees (between 15–30 yrs old).

ii. The ends waxed and then air or kiln dried to reduce the moisture content.

iii. The waxing is essential as it prevents quick moisture loss from the end grain which could cause cracks or drying cones.

b. Machining

i. The cleft undergoes various machining processes to be cut into the basic blade shape.

ii. Even at the machining stage, the crafts-man's expertise is essential.

c. Pressing the Blade

i. The willow fibres have to be compressed in order to strengthen the timber sufficiently to withstand the impact of a cricket ball.

ii. Generally, the bat is pressed up to 4 times up to 2,000 lb per square inch.

d. Fitting the Handle

i. Handle being spliced into a blade.

ii. The handle and rubber strips are fitted through the precise splicing of the handle into the blade.

iii. The handle is secured using water resistant wood glue and left overnight to dry.

e. Hand Shaping

i. The blade is shaped by pulling off the willow with the draw knife.

ii. As with all the other stages of production, the hand shaping is absolutely unique.

iii. During the shaping, the bat is tested for balance.

f. Sanding

i. Drum Sanding.

ii. Once shaped, the bat will be both coarse and fine sanded.

iii. The characteristic finish of a Salix bat can be attributed to very fastidious sanding.

g. Binding, Polishing & Labelling

i. Binding a handle.

ii. Traditionally bats were boned instead of polished Species the use of a bone or piece of cane to compress the fibres giving both the final finish and a final pressing.

iii. Labels are applied to the face, back and sides of the bat.

iv. All bats then undergo a final quality inspection before being packaged and distributed to shops.

7.2 Hockey Sticks

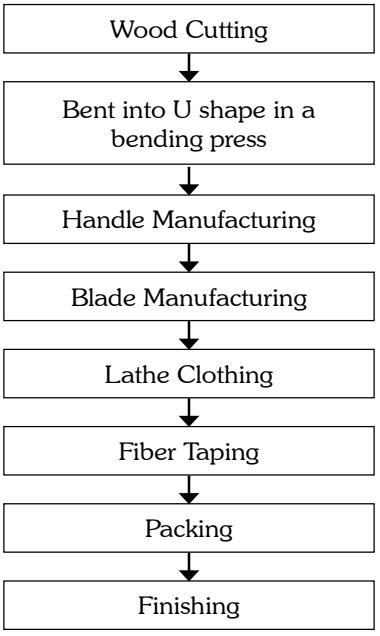
a. **Sizes (Inches)**

27, 30, 33, 34, 35, 36, 37 and 38

b. **Raw Material**

Mulberry Wood, Popular Wood, Glue, Fibre Tape, Lathe Cloth, Sticker

c. **Process Flow Chart**



i. The greatest variety comes in the materials used to make the shaft of the stick. The three primary materials are wood, aluminum, and composite.

ii. Composites are comprised of reinforcing fibers, such as graphite and kevlar, and binders, such as polyester, epoxy, or other polymeric resins that hold the fibers together.

iii. Composites are used both by themselves to form hollow shafts and to reinforce wood sticks, much in the same way as fiber glass is used. These materials are generally stiffer and lighter than fiber glass.

iv. Length and width of Hockey sticks is 36–42 inches length, and 2–3 inches wide.

v. **Weight:** Maximum weight of a hockey stick is 737 grams.

vi. Logs are fed through a multi-bladed saw that cuts the wood into thin sheets. The sheets of wood and layers of fiber

glass (if it's to be used) are coated with adhesive and pressed together in a heated hydraulic mold.

vii. The *finished laminate* is then cut into the rough shape of a stick and shipped to the stick maker.

viii. The stick maker uses a saw with splayed teeth to cut the rough wood into the desired shape. Each pass on the saw cuts two corners of the shaft, so after two passes the shaft has four beveled corners and has reached its final shape.

7.2.1 The Manufacturing Process

i. A block of ash is glued onto the end of the stick.

ii. This will form the joint between the shaft and the blade.

iii. A groove is cut into the centre of the block to accept a tongue shaped into one end of the blade.

iv. The tongue and groove are glued, fit together, and placed in a heated hydraulic press to cure for about half an hour

v. The dried assembly is then shaped and smoothed on a large drum sander.

vi. The fiber glass is pulled over this assembly like a sock and is dipped in resin and allowed to dry. Once dry, the stick is again sanded to remove any rough edges.

vii. Graphics are silk-screened on and parts of the stick may be painted, and the stick is finished with a clear gloss varnish.

7.3 Badminton Racquet/ Tennis Racquet

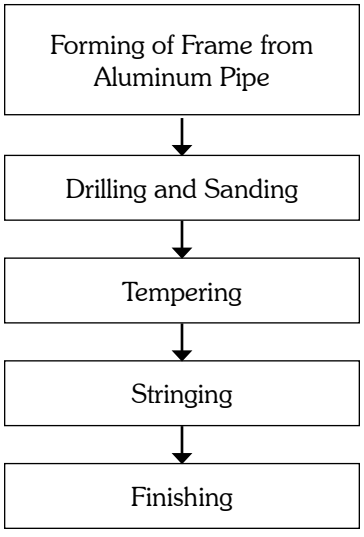
a. **Sizes (Inches)**

22, 25 and 27

b. **Raw Material**

Aluminium Pipe, Ducca Wood, T point Aluminium, Gut, Tape, Gum

c. **Process Flow Chart**



7.3.1 A badminton racket is strong with respect to impact and twist and is high in surface stability. A badminton racket includes.

i. A frame formed circularly.

ii. A shaft joined to the frame.

iii. A joint installed reaching inside the frame.

iv. The shaft at a joint portion of the frame and the shaft.

v. And an expandable resin placed between the joint and the frame.

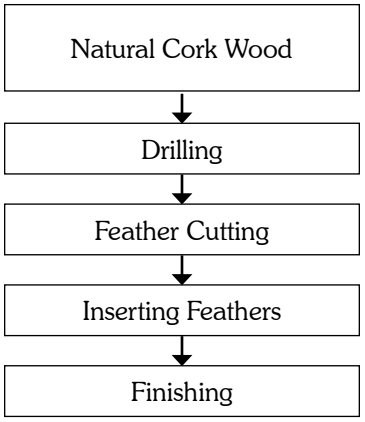
vi. A badminton racket manufacturing method includes an expandable resin placing process that places an expandable resin that expands when heated on the outer periphery of a portion of a joint, the joint being to be installed to reach inside a frame formed with the resin sheet tube and inside a shaft, the portion being to be installed in the frame.

7.4 Shuttle Cock

a. **Raw Material**

Feathers, Natural Cork Bottom, glue, polish, detergent, washing blue and packaging consumables.

b. **Process Flow Chart**



7.4.1 Manufacturing Process

The process of manufacture of the shuttle cock is very simple. The white duck feathers are generally used for the production of the shuttle cock. Sometimes hen feathers are also used for the cheaper variety of shuttle cocks. The feathers are first of all sorted out for selection of good variety of feathers. Then the feathers are washed with detergent for 30 to 60 minutes. Then, they are treated for giving the brightening effect. The washed feathers are then properly dried and cut to 3" size with the help of the scissors. The feathers are then rounded off and pruned at the top. Then good quality cork bottom are taken. Altogether 16 nos. of bores are made on the flat surface of the wood cork with the help of cork boring machine. The feathers are then inserted into such bore and fixed with glue. Then 16 feathers thus inserted into the cork are knought with the Cotton thread. Gelatine is then smeared round over the knoughted thread. Then silk or cotton ribbon is attached at the Junction of the cork and feathers at the base of the shuttle cock. A brand sticker is also put round the cork and attached with the glue at base middle of the cork of the shuttle cock. Finally, the shuttle cocks are weighed on a balance and the weight is adjusted with the help of the small steel pins.

7.5 Skates

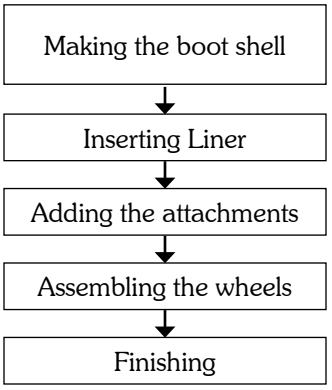
a. **Sizes**

Full, Youth

b. **Raw Material**

Aluminium, Cloth, Steel, ball bearings, buckles, Nylon, Plastic, Synthetic Material.

c. **Process Flow Chart**



7.5.1 The Manufacturing Process

i. Separate companies manufacture the individual in-line skate components. For example, manufacturers of skate-board wheels also make in-line skate wheels. Another company makes the boot shell and chassis; another manufacturer provides the braking system. In-line skates are manufactured using an assembly line process whereby all components move down a conveyor belt and are assembled piece by piece.

ii. **Making the Boot Shell:** In-line boot shells are made by a process called injection moulding. Urethane plastic is injected into a mould to form the boot shell, much like a ski boot. Dye may be added for colour. When the mould has cooled, the injection-moulding machine ejects the finished boot.

iii. **Inserting the Liner:** Soft cloth or plastic foam is cut to various sizes and inserted into the boot shell. The dimensions of the liner should conform to the skater's foot.

iv. **Adding the Attachments:** The remaining shell cuff (as well as the tongue), metal buckles, and plastic or Velcro fasteners are attached to the shell. Most of these pieces are bought pre fabricated.

v. **Assembling the Wheels:** The frame, including wheels and bearings, is attached to the boot shell by rivets or by a coupling system. The frame is often assembled ahead of time. The wheels are placed in a row and attached to the frame. On inexpensive models, the boot and frame are injection moulded as one unit.

vi. Once the in-line skate has been assembled, it is boxed and delivered to stores.

7.6 Football

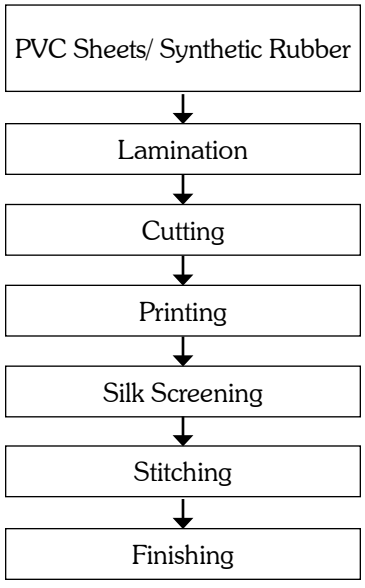
a. **Sizes**

Nos. 1, 2, 3, 4 and 5

b. **Raw Material**

Synthetic Leather, Rubber bladders, Cloth, Latex adhesive, Thread

c. **Process Flow Chart**



7.6.1 The Manufacturing Process

i. There are two main elements of the soccer ball. One is the inner bladder, the second is the outer covering. Sometimes the whole soccer ball is made under one roof.

ii. In many cases, the bladders are manufactured and the covering is die-cut and imprinted with logos at a central factory, and the stitching is done by hand elsewhere. The ball covering consists of 32 hexagonal panels, and the hand stitching of these is tedious and exacting work. Material for a cheaper ball will receive a two-layer backing. A sturdier, more expensive ball will have four layers of cloth attached.

iii. The bladder can be made from either natural or synthetic rubber. The raw material is gently heated and forced into a mould, where it forms a balloon. As the material cools, it wrinkles. Next, workers remove the bladders and partially inflate them to smooth them out.

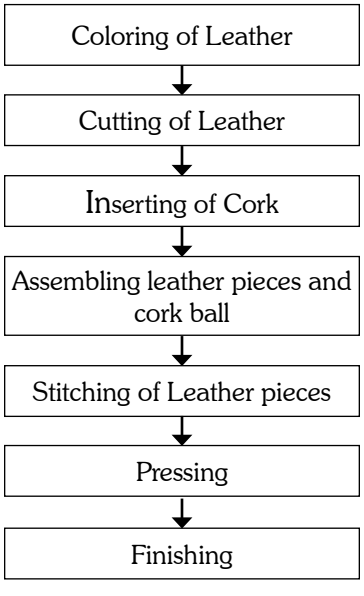
iv. The 32 panels are sewn together by hand. The stitcher inserts the bladder and sews the final seams. In order to ensure that the bladder has not been punctured by a needle during *stitching,* a worker pumps up the ball. Then, the finished ball is deflated again and packed for shipping.

7.7 Cricket Ball

a. **Raw Material**

Leather, Cork, Thread

b. **Process Flow Chart**



7.7.1 The Manufacturing Process

A cricket ball is usually made with the use of a centre of string, cork strips over it and lastly an

outer covering of leather. The basic raw material for a cricket ball is same for women as well as men cricket ball, just their dimension and weight are different. The balls are made in accordance with the international parameter. Cork strips are wrapped with tightly-wound string. The external skin of leather is divided and cut into four pieces and sewn simultaneously with a stick out seam. The core of every ball has six strips of seaming having three on either side of the seam. This seaming in a ball aids the ball to turn or spin along with making it easy to grip for bowlers and fielders protecting balls from hitting the boundary. Depending upon the need of four piece or two piece leather ball, leather is cut into four and two pieces respectively. Leather pieces are the stitched with a thick thread to join the two pieces. Stitching is done quite roughly but is equally of good strength. After stitching, two half pieces of leather can be used for assembling of ball, which is also the subsequent process.

Assembling of ball is done manually and with the aid of manual tools operator who holds the cork ball and leather piece together. The operator with needle in one hand and leather and ball in other grip effectively and go on to puncture and stitch the ball and leather together.

At this stage of processing, operator confirms the ball assembly to get the pre pressing ball shape. This is a last stitching of ball involving skilled operator doing the stitching work with the help of manual stitching tools. In order to give perfect shape to the ball, the operator uses beautiful threads around 63 and 64 that bind the ball completely making it sturdy as well as long lasting.

7.8 Raw Material For Protective Gear

1. **Glove:** Latex Rubber, Thread, Chemical
2. **Leg Guard:** Cloth, Leather, Thread Buckles
3. **Helmet:** ABS Plastic, Fiberglass, carbon fiber, titanium, steel and high density foam etc.
4. **Abdominal Guard:** Plastic, Buckles
5. **Thigh Guard:** Cotton Fabric, Foam
6. **Arm Guard:** Synthetic Plastic, Foam
7. **Chest Guard:** Synthetic Plastic, Foam
8. **Shin Guard:** Synthetic Material, Foam
9. **Elbow Pad:** Cotton, Leather, Foam
10. **Knee Pad:** Cotton, Leather, Foam
11. **Wrist Guard:** Cotton, Leather, Foam

8. TAX INVESTIGATIONS

8.1 Common Issues for Investigation

8.1.1 Examination of Balance Sheet

i. In the course of assessment proceedings, the AO should conduct the investigations in the case on the usual parameters common for all the manufacturing enterprises by first considering the important aspects of the Balance Sheet such as Capital addition, Addition to fixed assets, Capital expenditure and Investments, capacity building, sundry creditors, unsecured loans, advances and accretion to Capital account. He should also carry out ratio analysis.

8.1.2 Examination of Manufacturing and P&L Account

i. After considering the Balance Sheet and comparing it with last year figures the AO should next concentrate on the Manufacturing and Profit and Loss account-the AO need to understand the manufacturing process, compare the quantitative consumption of raw materials, production of the finished goods and expenditure claimed on job work and labour. The quantitative tally should be compared with the figures for the preceding year and with other concerns in similar lines of business. The AO also needs to consider the closing stock, manufacturing expenses claimed, value addition in the course of manufacturing,

running expenses, transportation inward/ outwards etc.

8.1.3 Comparison of G.P. Rate

i. The AO should also look into the GP rate reflected by the assessee and compare the same with other similar cases and also analyze any major variation in the input/ output, expenses ratios or borrowings as compared to previous years.

ii. The purchases and sales made by the assessee can also be verified from the GST returns filed by the assessee.

iii. The Assessing Officer must use the departmental information already available in the shape of big data analytics (Insight software), 360 degree profiling etc. to get useful inputs.

Since these are common issues for all the manufacturing units, the same are not being discussed here in detail for the sake of brevity, rather, the issues specific to the sports goods manufactures are discussed hereunder in the following paras.

8.2 Issues Specific to the Sports Goods Manufacturers

8.2.1 Cost of Raw Materials

The specific item of sports goods requires a specific raw material. As discussed above in para 2, a special type of wood i.e. Willow is used for Cricket Bats, Mulberry is used for Hockey Stick and special aluminum and wood is used for Racquets. It is also seen that since this industry is mainly operating in the unorganized sector or small units detailed quantitative tally and production records may not be available, the AO has therefore to resort to indirect methods of verification of purchases and consumption of raw material and production of final product. The AO should proceed in a step by step manner so that he does not miss any important clue which can be used for verification of the actual production. The AO can proceed by:

1. Checking procurement of Raw Materials:

i. The AO should check the procurement of raw materials by verification of transportation charges involved *viz-a-viz* the quantities reflected in the books of accounts, verification of payment towards loading–unloading and other related expenses.

ii. The AO must insist on production of books of accounts along with original bills/ vouchers for examination. The AO should minutely scrutinize the transport challans/ bills/ GR *viz-a-viz* the purchase bills since every transport bill is linked to specific bill/ bills. The bills need to be thoroughly investigated to see if they are genuine or fabricated.

iii. There is a common practice to inflate the purchase prices. One modus operandi is by layering of transactions in order to reduce his tax liability by placing various fictitious and non-player entities. It was also seen that in these kind of layering transactions, the assessee introduce bogus purchases or enjoys the benefit of bogus input credit of GST by booking the purchases in its books of accounts without any delivery of goods. The assesse escapes from the verification of the same as it is difficult for the revenue department to trace the transaction beyond 3 to 4 layers. The AO with his application of mind should segregate such type of transactions taking clue from the name of the parties, quantum of transactions and ascertaining the genuineness of the purchase/ transport/ toll tax receipts of the goods purchase by the assessee.

iv. GST Record-the AO should procure the GST record to verify the authenticity of purchases and also to verify whether there is any inflation of purchases. Cases have been detected wherein sale invoices

of ITC firm had issued fake invoices to another firm in a circular manner without any concomitant movement of goods or payment for such transactions, thereby wrongful availing of and utilization of fake input tax credit.

v. Generally it is seen that the entry provider or bogus GST input providers had vague and inconspicuous name and addresses and are easily segregated from the real purchasing parties. It is also seen during investigation of these kinds of bogus account that the bogus entry provider generally operate from the same branch or same bank to avoid from the difficulties arising out of transfer of money from one bank to another. The AO should take the help of suitable computer software to trace the origin of such bogus entries through various layering accounts.

2. Quantitative tally through verification of consumption of one main Raw Material:

i. **Cricket Bats:** In the case of Cricket Bats, it has been gathered, that since the export or transportation of Kashmiri willow wood is banned, the sports goods manufacturers procure the semi-finished bats called Cleft from Kashmir with a fake handle as bats, they then remove the fake handles (which are recirculated), and use the cleft for the purpose of manufacturing of bats. This final finishing is done at their units. Thus the AO should check the purchase bills and verify the number of clefts procured by the unit which can then be compared with the actual production of bats shown by the unit to ascertain any suppressing of sales. Normally, number of clefts should be equal to the number of bats produced with adjustment of only-2 to 3% for any breakage or damage. If there is a major difference it would be a clear indicator of suppressed production.

ii. **Footballs:** Similarly, in the case of Footballs, ready-made bladders are normally procured by the units from outside. Most of the bladders are of NK brand. The football is manufactured by sewing 32 panels and inserting the bladder inside. Thus the number of bladders procured and used can be a parameter to ascertain the actual number of footballs produced by the unit. If there is a major difference it would be a clear indicator of suppressed production. It is also important that each football has 32 panels and if the number of panels produced are not divisible by 32 it shows that the data is not authentic.

iii. **Shuttle Cocks:** In the case of shuttle cocks, the standard item that is procured is cork. The same method can be applied on the basis of number of cups and corks, with major difference being an indicator of suppressed production

iv. **Cricket Balls:** In the case of cricket balls, the standard item that is procured is cork. The same method can be applied on the basis of number of cups and corks.

v. Similarly an important item of the manufacturing process should be picked up to cross verify the consumption of raw-material and production of final product.

vi. If the person is also purchasing an item ready-made which it is manufacturing that needs close verification as most of such purchases are bogus. The manner of payment, the transportation and even the existence of parties need verification.

3. Cash Payments for purchases and 40A(3) Compliance:

i. The cash payments made for the purchases should be closely checked specially the payments made/ received repeatedly of the denomination of just below Rs.10,000/-.

ii. Wherever found suspicious, the AO should resort to calling of information under Section 133(6) or summons under Section 131 for independent verifications.

iii. Similarly purchases from parties where no payment has been made during the year also needs deeper investigation.

8.2.2 Labour Charges/ Job Work

As already intimated, the sports goods industry is a labour intensive industry and majority of the manufacturing process of goods is completed through job work done through contractors. The AO should identify the kind of job work required for each type of sports good whether it is polishing or stitching or cutting etc. The small time contractors take the semi-finished or raw products from the manufacturing units and get the necessary job work done by manual labours or sometimes entire families where all the members of the family indulge in the job work. The manufacturer makes the payment to the contractor on per piece basis:

i. The AO should check the records of the goods given to the contractor for job work or received after job work whether it is gate pass, outward/ inward challan books or simply registers maintained by the assessee and verify the same against the actual production shown in the accounts.

ii. The AO needs to verify both outgoing and incoming material

iii. In number of cases it may be found that only rough records of goods sent for job work and finished goods received back would be available. In such cases these rough records would form the basis of verification of actual production.

iv. The AO should verify the payments made to the contractor on per piece basis and compare the same with other similar cases.

v. The AO should also check the mode of payments made by the unit to the contractor for violation of Section 40A(3) and also check whether the TDS has been deducted on payments made to contractor and deposited within stipulated time.

8.2.3 Verification of Stock

i. The AO should check the stock registers maintained by the assessee along with day to day production records to find any discrepancy.

ii. The AO should ask the assessee to submit month wise stock statement with month wise manufacturing and trading account to check whether there is any negative stock at any given point of time which means that there are purchases/ sales outside the books. This will also highlight whether there is any discrepancy or increase in ratio of expenses in any period of time *viz-a-viz* the manufacturing/ sales of that time. High expenses without any increase in output/ sales means sales outside books of accounts.

iii. The monthly stock shown in trading accounts may also be verified with stock statements submitted to the banks.

iv. In the post GST era the assessee is under obligation to maintain the quantitative detail of the stock in the GST R3B return form filed with GST department. The AO should call for all these GST returns and reconcile the purchases and sales shown in the Income-tax Return with these GST returns.

8.2.4 Commission Agents

i. The sports goods industry is highly competitive and the commission agents are indispensable in this line of business. The extent of commission claimed to have been paid and the actual services rendered should be scrutinized to ascertain whether there is any direct nexus between commission paid and the services rendered by the commission agent.

ii. As commission agents are not covered under purview of presumptive income under Section 44AD of the Income-tax Act, 1961, issue related to cash expenses/ cash payments (exceeding Rs. 10,000/- w.e.f A.Y. 2018–19) should be examined so as to determine any disallowance under Section 40A(3)/40A(3A) of the Act. By doing so we can check the tax evasion by the commission agents, if any as well as we can widen the tax base.

8.2.5 Inflated Costs and Suppressed Sales

i. The manufacturer derives a huge margin of profit from his established brand whereas no expenditure on account of R&D of the product is generally seen in these kind of manufacturing unit.

ii. The assessee in order to deflate the G.P., generally makes bogus purchases and creates sundry creditors which are unverifiable and inconspicuous. The AO with his application of mind should identify such type of bogus creditors and quantify the bogus purchases made by the assessee and should arrive at the actual profit earned by the assessee in these kind of sports goods manufacturing.

iii. In the sports manufacturing units, the assessee is under obligation to maintain strict compliance with labour laws, EPF, ESI, naga form etc. in respect of labour engaged and in order to avoid the complications and punitive legal actions, the assessee prefers to under report the labour charges/ wages, leading to massive out of books of productions and thereby suppressions of sales in the Income-tax Return.

iv. There are also cases in which the assessee would try to inflate the labour expenses by claiming higher expense on labour but cross verification with other units can easily identify such units.The AO should try to ascertain the quantum of manufacturing activities undertaken by him and the exact number of labour required for the same by making comparison with the similar units.

v. A very vital parameter to ascertain the actual production of goods is to use a chart of monthly use of power and fuel and the corresponding production shown in the books. Any excessive use of power and fuel for a period as compared to production in the same period may mean sales outside books.

vi. The ratio of consumption of power and fuel with the corresponding production/ sales should also be compared with the similar cases. The power bills may be also got verified from the Electricity Board.

vii. The AO also needs to verify the expenditure on packing and whether the same is commensurate with the production/ sales as the case maybe.

8.2.6 Payments through Credit Cards

This is not specific to sports industry, however, it is often seen that in recent times firms are taking number of credit cards in the names of directors, partners or other employees. Payments for business expenses are made by the units using these credit cards. There is nothing wrong in using credit cards for making payments, however, in order to encourage their customers to use their cards for making payments, credit card companies provide cash back to the customer on certain categories of payments made through credit card especially on booking of airline tickets etc. Some Banks make cash back upto 30% on transactions made through credit card. Such cash backs received in respect of payments made for business expense is to be credited in the books of accounts of the firm as business receipt but it has been seen that the cash back is used by the Director/ partner for own or family's personal use like travelling, hotel stays etc. The AO should verify such cases and add back the amount involved as business receipt.

8.2.7 Brand Labels

In the case of Sports Apparel manufacturers, it is seen that they manufacture the apparels exclusively for major brands such as Nike, Addidas etc. and it is a practice that these brands supply their exclusive Brand Labels/ Logos to the manufacturers for using the same on the apparel or a sticker on bats or on other sport goods and a strict control is kept on the quantity supplied to and used by the vendor. The AO should obtain quantitative details of such labels supplied to and used by the manufacturer and get the same verified from the supplier to ascertain the exact production.

8.2.8 Export Units

i. Director General of Foreign Trade (DGFT) under the aegis of Ministry of Commerce is responsible for implementing the Foreign Trade Policy with the main objective of promoting India's exports. As Sports Industries are mainly export oriented industries, it is imperative to verify exports in particular. DGFT issues unique code to all importers/ exporters and this is known as importer exporter code(IEC). There is a website of ICEGATE through which AO can fetch fruitful results with regard to Importers/ Exporters. The AO can extract consolidated data of imports/ exports made by Sports Industries for verification purposes. Summarized date of bills of entry (BE) and shipping bills can be obtained through this website after entering IEC of Importers/ Exporters.

ii. Mismatch related to customs duty/ duty draw backs (DBK) can be verified. Verification can also be made from Ports concerned through which imports/ exports are done. Verification can also be made from Clearing and Forwarding Agents of importers/ exporters. For mismatch in DBK, bank entries can also be analyzed. Foreign currency fluctuations can also be seen and taken into account. With regard to certain payments made to entities, requirement of deduction of TDS and 15CA certificates be seen.

iii. Sometimes, sports goods manufacturers export the goods through the companies/ firms other than companies/ firms in which manufacturing is done. The sale price of these products to exporting concerns is shown at lesser rate than the actual market price. The AO should compare the sale price of goods of a manufacturer supplied particularly to its own exporting concern should be compared with the sale price of the same products to outside parties.

8.2.9 Taxation of Royalty Received

Generally, during the course of assessment, it is seen that the sport manufacturing industries receive royalty from the off shore cricket control boards and foreign sports goods companies for using their brands, name and logo in the live broadcast matches and the sports apparels worn by the players in the International matches. Similarly, some companies also receive grant of license for the live and recorded broadcast of the matches held off shore lands. They claim it as exempt on the basis that there is no business connection with India and on the basis that it has not arisen or received in India. The AO should keep in mind that these matches were broadcast in Indian Territory and the income by way of advertisement revenue and subscription revenue has been received by the assessee. Moreover, it is fact that without the receipt of the signals on account of the matches to be played, no income on account of royalty would have accrued to the assessee on this account. Hence, there is a business connection between the assessee and the cricket boards/ sports companies covered within explanation 2 Section 9(1)(vi) of the Income-tax Act, 1961 being in the nature of royalty and thus taxable in the hands of the assessee.

8.2.10 Endorsements

i. Similarly it is also seen that the major sports manufacturing industries are claiming huge expenditure on account of endorsement of their goods made by the players in and outside the country. The AO should verify the genuineness of the expenditure claimed on account of the endorsement in the Income-tax Return filed by them.

ii. During the assessment proceeding the AO should also consider the provision of Section 195 (2) in case any payment has been made to a non-resident.

8.2.11 Sales to Related Parties/ Transfer Pricing Angle

It is often noticed that sports goods manufacturers export their goods through companies/ firms other than in which manufacturing is done. The sale price of these products to exporting concerns is shown at a lesser rate than the actual market price. This practice is adopted to siphon off business profits to the exporting concern which may not be taxable in India or may be taxable at a lower rate. Thus the AO needs to verify whether there is any transfer pricing angle involved in the case of the assessee:

9. Action Points in brief for the Assessing Officers.

i. Study the Balance Sheet and Profit and Loss account.

ii. Insist on production of books of account with original bills/ vouchers.

iii. Verify sales/ purchases shown by assessee from the GST returns.

iv. Verify the procurement of raw material by checking transportation charges *viz-a-viz* the quantities reflected in the books.

v. Cross Check transport documentation with books of accounts, purchase bills.

vi. Indentify for bogus entry/ input providers as discussed in para 3.2.1 above.

vii. Verify quantitative details on the basis of consumption of basic raw material.

viii. Use the Customs Department website of ICEGATE for verification of export/ import done by the assessee as well as any duty drawbacks received.

ix. Check for violation of Section 40A(3).

x. In case of job work, check the original records maintained for movement of goods for job work.

xi. Compare per piece payments made to contractor with other similar cases.

xii. Check TDS deduction on payments made to contractor and commission agents.

xiii. Compare month wise stock statement with month wise production to detect any variation.

xiv. Check quantitative details of stock with GST R3B.

xv. Compare monthly consumption of power & fuel with the corresponding monthly production to detect any variation.

xvi. Verify labour expenses with the other Govt. departments such as ESI, EPF etc.

xvii. Check payments made through credit cards by proprietors/ partners.

xviii. Check consumption of brand labels.

xix. Check royalty received by the assessee.

xx. Check for payments made for endorsements and applicability of TDS provisions.

xxi. Transfer Pricing Angle

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Designed and Printed by: Excel Printing Universe, New Delhi, e-mail: printing@groupexcelindia.com, Mob.: 9899127755